RJR

R.J.Reynolds Industries, Inc.

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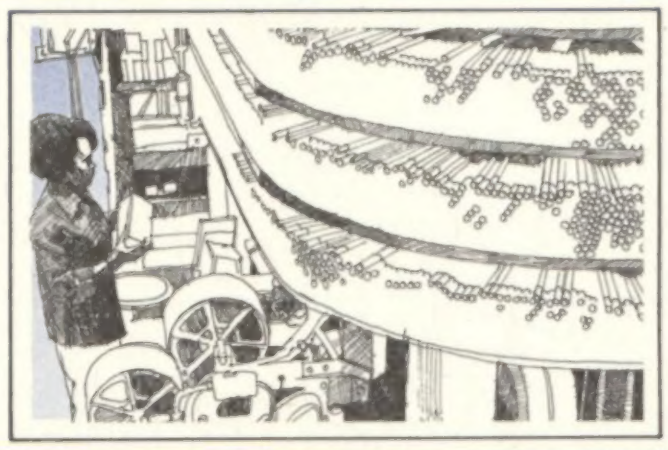

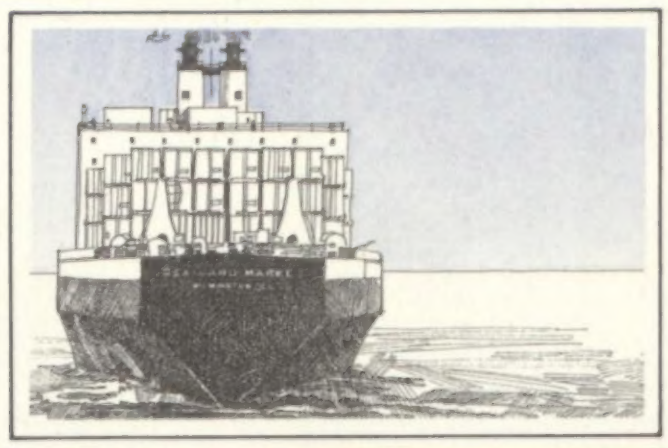

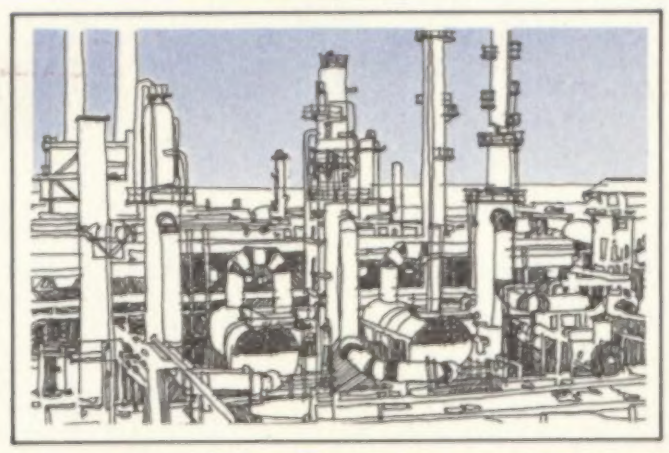

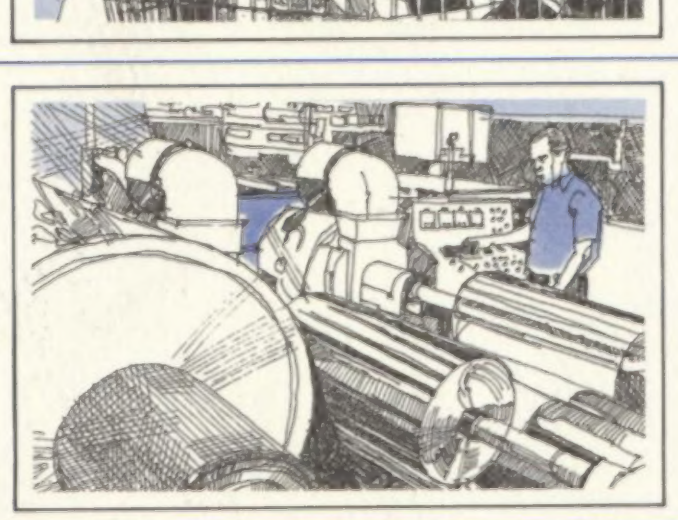

1974 Annual Report

HIGHLIGHTS

(Dollar Amounts in Thousands Except Per Share Statistics)

	1974	1973	Change
FOR THE YEAR			
Net sales and revenues	$4,500,909	$3,294,913	+37%
Net earnings	310,698	263,569	+18%
Net earnings per common share:			
Primary	6.99	5.89	+19%
Fully diluted	6.24	5.34	+17%
Net earnings as a percentage of net sales and revenues	6.9%	8.0%	
Return on average total capital	15.2%	14.5%	
Return on average common stockholders' equity	19.3%	18.1%	
Capital expenditures	$ 125,832	$ 339,729	–63%
AT YEAR END			
Working capital	$ 827,807	$ 720,473	+15%
Book value per common share	38.27	34.13	+12%
Number of stockholders	125,176	124,371	+ 1%
Number of employees	32,454	31,477	+ 3%

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LETTER TO STOCKHOLDERS

Dear Stockholders:

All in all, 1974 has been a good year for your Company, and we are happy to tell you that new records were set in sales and revenues and net earnings.

The great thing about it, we think, is that 1974 is the first year that really points up the advantages of our diversification. The way the non-tobacco subsidiaries performed and grew more profitable played a big part in the total results. Because we made more money in those businesses, we were able to put more money into the tobacco business. That is a good example of how your Company's expansion into other areas is beginning to pay off.

Before telling you more about the 1974 results, we want to remind you that with the arrival of 1975 we are celebrating our one hundredth birthday. Nobody knows the exact date, but it was one day in the spring of 1875 when R. J. Reynolds opened his first "little red factory," in what was then Winston, North Carolina. To mark this centennial year, we are sending you with this report a special commemorative booklet. It has a lot of pictures, plus some text, and we hope you will find it interesting.

The dusty road that led from the "little red factory" a hundred years ago has circled the earth. A third of our employees now live outside the United States, and the number is growing rapidly; a third of our revenue is generated abroad.

In our letter in the last annual report we said we were going to visit as many operating units of the Company as we could. And that is what we did. Our travels in 1974 took us to Company locations across the United States and in Europe and the Orient. It was a great experience. Not only were we able to study business problems and opportunities first hand, but we also were able to meet our fellow employees and get to know them on a personal basis. At the same time, these visits gave us the chance to talk with government officials, customers, stockholders, investment and financial people and members of the business press.

During the year we also began to broaden our contacts with the financial and investment communities. The first meetings we had were with security analysts in Atlanta, Los Angeles and San Francisco. One thing we soon found out is that, with Reynolds' diversification and growth, there is a lack of understanding of the many aspects of our worldwide businesses. This year we will keep trying to improve this situation, and we have already set up sessions in four more cities.

Because, as we have said, the Company now gets a third of its revenue from outside the United States, and that is growing, your management believes it needs as much good advice and guidance as it can get from people in positions of leadership in other countries. In December we took a step that just might turn out to be one of the most important developments of last year for the Company. We announced the formation of an International Advisory Board, made up of prominent businessmen and industrialists from Brazil, Canada, Germany, Holland, Japan, the United Kingdom and the United States. The first meeting of the group will be held here in Winston-Salem this spring. With the Company and its subsidiaries becoming more and more active internationally, we feel that the members of this board, in their advisory capacity, will be of great help as we develop our guidelines for policies and operations outside the United States.

Getting back to the 1974 results: The record performance showed net sales and revenues up 37 percent over 1973—for the first time exceeding four billion dollars. Net earnings gained 18 percent. Net earnings per common share moved up to $6.99 from $5.89 in 1973, on a slightly greater number of shares outstanding. These results are discussed in the financial review, starting on page 14.

In keeping with the Company's policy of excluding inflation from inventories, late in the year we added sugar and aluminum to the LIFO ("last-in, first-out") method of valuing inventory. We have used LIFO for tobacco since 1956.

The Board of Directors at its October meeting voted to increase the quarterly dividend on the Common Stock to 72 cents per share. This was an increase of 5 cents over the amount paid in the previous five quarters. Except for 1971, when federal guidelines were in effect, the dividend payment per common share has increased each year for the past twenty-one years. Last year was the seventy-fifth consecutive year of dividend payments on the common shares—a record that reflects the stability of this Company and the ability of its past managements.

Your Company's tobacco business met a number of challenges with success in 1974. Reynolds Tobacco continued its leadership in the domestic cigarette market with record sales and a slight increase in market share. It also increased exports of its U.S.-made cigarettes.

Fine progress was made in the foreign cigarette market, which is growing fast. Reynolds Tobacco International extended its business in Europe, South America and the Far East and stepped up its activities in a number of far-flung countries. In Canada, a successful first year was recorded by Macdonald Tobacco Inc., which was acquired by Reynolds in February, 1974. Macdonald produces cigarettes, cigars and smoking tobacco and has about 21 percent of the Canadian cigarette market.

Your Company's "five-year plan" for Sea-Land Service was completed in 1974. It was the first full year that all eight of the SL-7 containerships were available for operation. These ships, the largest

and fastest of their kind, had been delivered over a 15-month period starting in late 1972. Expansion and modernization of support facilities continued in 1974. With the addition of two new SL-18 class containerships, Sea-Land's capacity was more than doubled on the route between the U. S. Gulf and South Atlantic coasts and northern Europe. Equally important has been the task of building and shaping Sea-Land's organization to take advantage of the potential created by this program. As a result of all that has been accomplished since 1969, Sea-Land is now more efficient than at any time since it has been a part of the Company.

Sea-Land operated in generally favorable world trade conditions for most of 1974, even though the level of trading was off in certain markets. The worsening world economic situation late in the year had some adverse effect on volume in the latter half of the fourth quarter.

American Independent Oil Company (Aminoil) had a successful year, although there was a good deal of turmoil, as you know, in the international petroleum industry. Despite swings in supply and consumption in world markets, Aminoil was able to market its full availability of products. In various parts of the world Aminoil continued to seek out new sources of petroleum.

Conditions in the grocery business in the United States and Canada were difficult in 1974. Even so, RJR Foods enjoyed a record sales year. Its market share grew in some key categories. The entire line of Chun King Oriental foods was reformulated, greatly enhancing product quality. Manufacturing and distribution facilities were improved and consolidated, as part of a major five-year program.

RJR Archer's overall 1974 results were good. The first half of the year was the best six-month period in Archer's history. However, by mid-year its customers were growing uncertain about economic conditions and their large inventories of many items, and they began to reduce their orders rather drastically for some products. Looking to the longer term, a new plant is under construction in Winston-Salem, and expansion of the Huntingdon, Tennessee, plant has been authorized. The latter, consisting of a new continuous aluminum casting facility, will be completed in late 1976.

The Company continued to carry out the broad energy conservation program begun in 1973 in anticipation of the acute fuel crisis that came early the following year. The resulting savings in energy usage have been impressive. On the surface, world shortages might now appear to have abated somewhat, but the crisis is still very much with us. We are persisting in our efforts to get every possible economy through this program.

In the year that has begun, we feel your Company is well positioned in each industry in which it operates. Our nation and the world are confronted with uncertainties. All of us no doubt feel, at times, that the problems we face are increasing at a compound rate. But along with uncertainties and problems always have come opportunities, and it is our belief that your Company is increasingly capable and prepared to take advantage of them and to continue to move ahead.

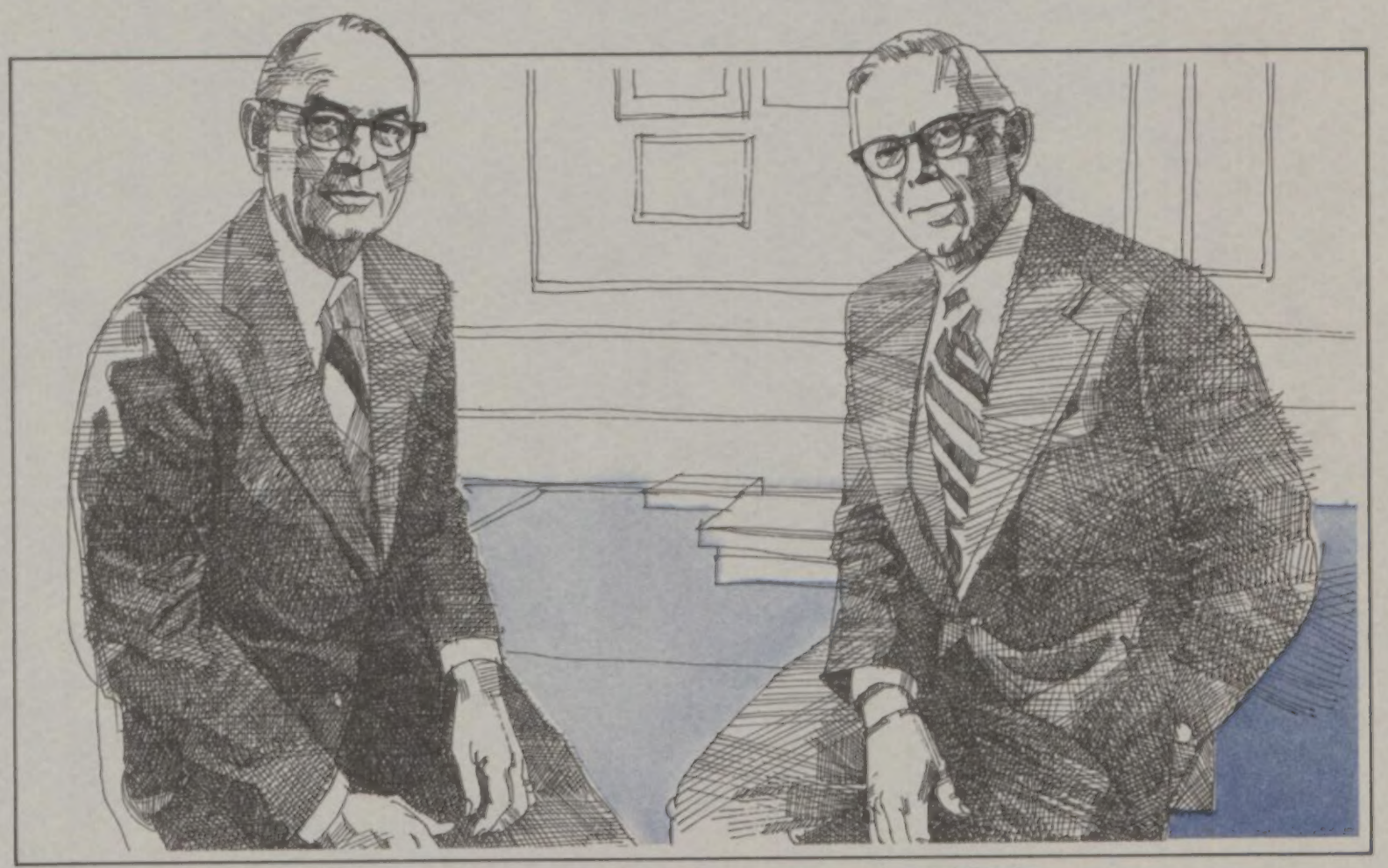
We want to express our great pride in the employees of this Company. In the hectic year just ended, beset by inflation, a slowing down of world trade, high prices of raw materials and the many other vicissitudes which business faced, they performed with tremendous loyalty, effort and effectiveness and, in spite of everything, attained new record results. We are most grateful to them. To you, the shareholders, we express our sincere appreciation for your continuing confidence and support and for your interest in the Company's advancement.

Respectfully submitted for the Board of Directors,

Colin Stokes
Chairman, Board of Directors

J. Paul Sticht
President

February 14, 1975



Colin Stokes J. Paul Sticht

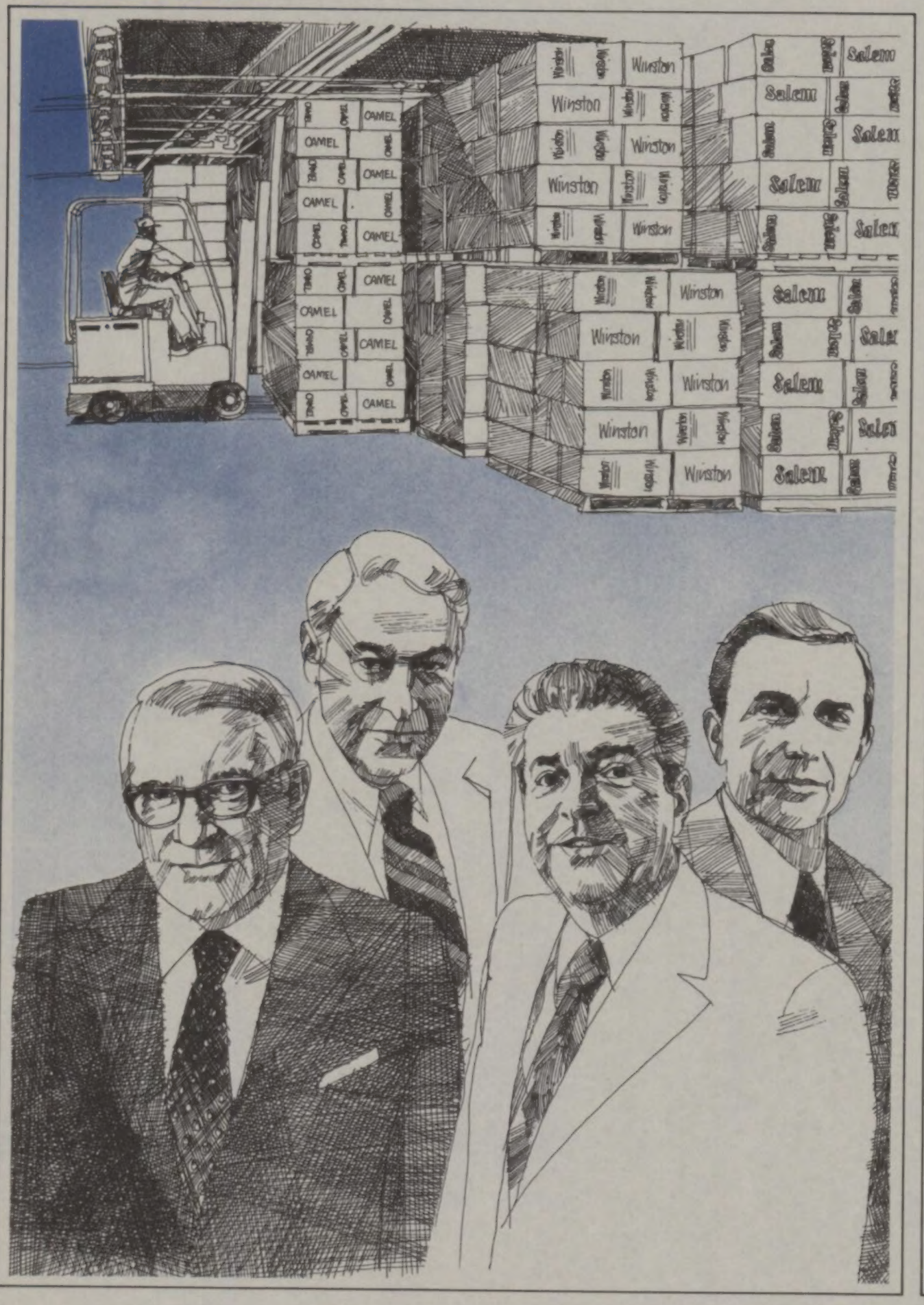
PRODUCTS AND SERVICES

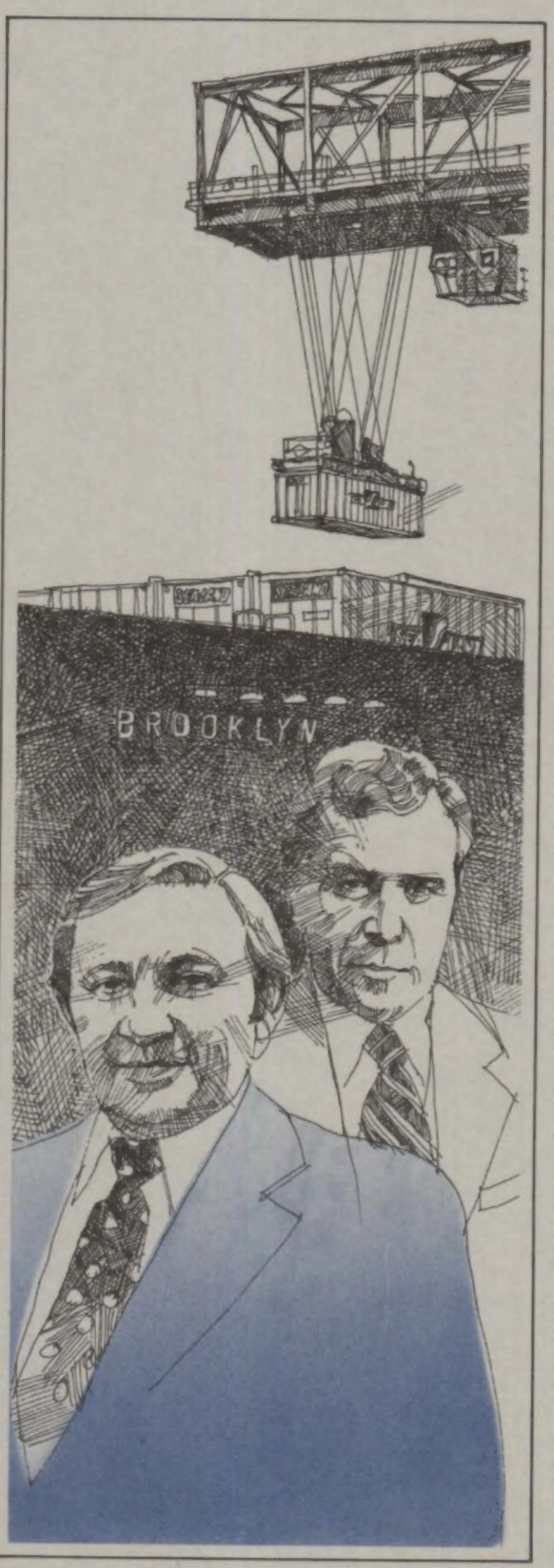
R. J. Reynolds Tobacco Company is the nation's leading manufacturer of cigarettes, including the popular WINSTON, SALEM, CAMEL, VANTAGE and DORAL brands, and also produces best-selling brands of smoking and plug chewing tobaccos and little cigars. Through its international operations the company's cigarette brands are sold in more than 140 countries around the world.

Sea-Land Service, Inc. provides containerized freight transportation to 124 port terminals in 48 countries, using more than 65,000 special containers and a fleet of 50 regularly scheduled containerships and 24 container relay vessels. Sea-Land's fleet includes the new SL-7 containerships, which provide the fastest containerized shipping service in the world.

Left to right: William S. Smith, Chairman, and Wm. D. Hobbs, President, R. J. Reynolds Tobacco Company; Jacques E. Borin, President, R. J. Reynolds Tobacco International, S.A.; G. D. Smith, Chairman, Macdonald Tobacco Inc.

Michael R. McEvoy, Chairman, left, and Paul F. Richardson, President, Sea-Land Service, Inc.





American Independent Oil Company (Aminoil) is an independent oil producer and refiner selling primarily to other oil companies in the Far East and Europe. Aminoil's principal sources of oil are the Divided Zone between Kuwait and Saudi Arabia, and Iran. It has a refinery and desulfurization plant in Kuwait.

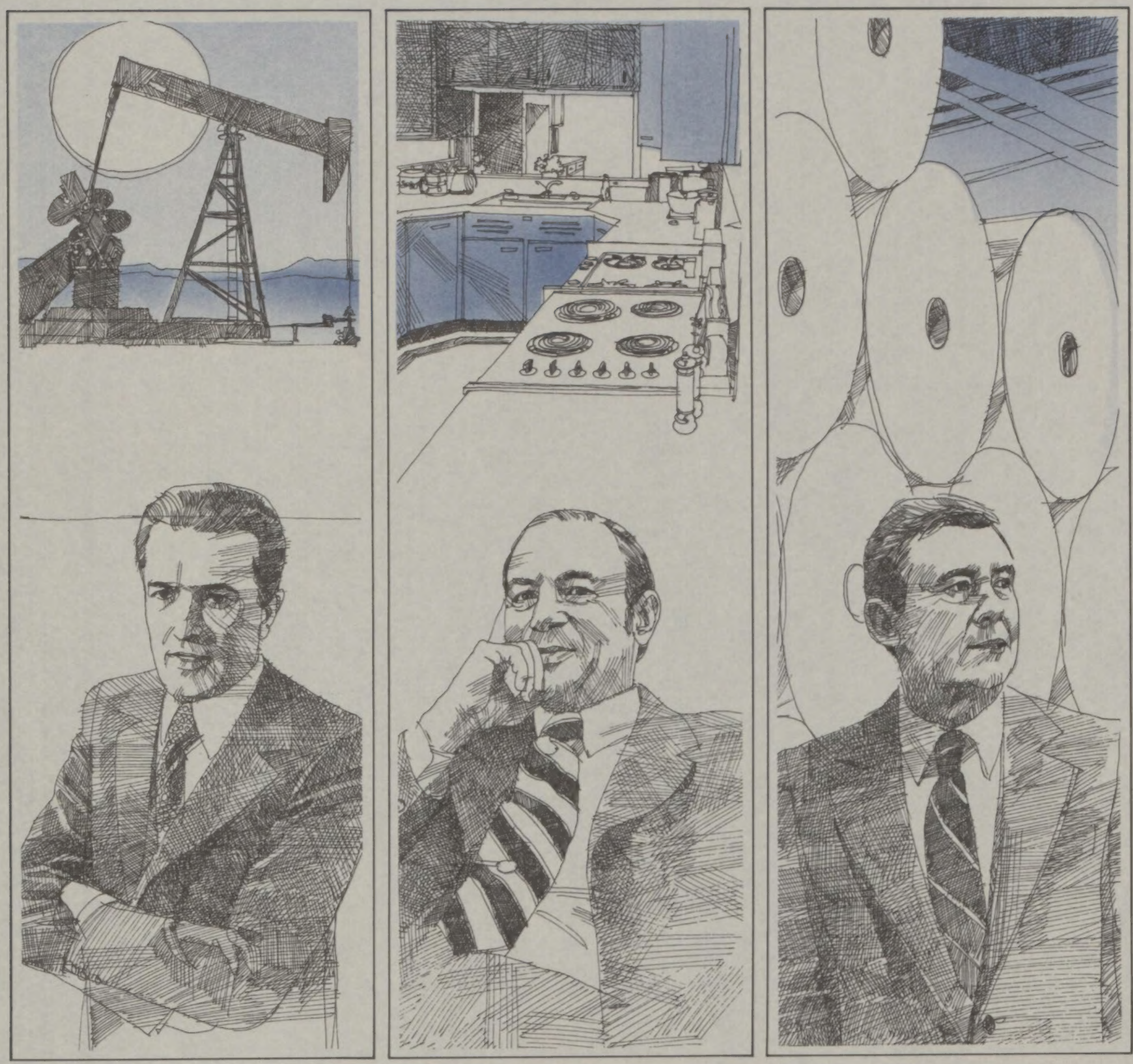
RJR Foods, Inc. makes a variety of foods and beverages, including many of America's long-time favorites and some of the newest, most innovative convenience foods on the market. Two of the company's most famous brands are HAWAIIAN PUNCH, one of the leading fruit drinks, and the CHUN KING line of canned and frozen Oriental foods.

RJR Archer, Inc. produces gravure-printed, multi-layered packaging materials for many of America's best-known consumer products. Archer is also one of the nation's leading suppliers of specialty foil and sheet aluminum products, florist foil and protective film wrap, and makes household foil and gift wrap for major department stores and other private-label retail outlets.

J. B. Sunderland, President, American Independent Oil Company.

J. Tylee Wilson, President, RJR Foods, Inc.

J. H. Corrigan, Jr., President, RJR Archer, Inc.



R. J. REYNOLDS TOBACCO COMPANY

R. J. Reynolds Tobacco Company continued its leadership in the domestic cigarette market in 1974 with record sales and a slight increase in market share.

Three of the company's brands—WINSTON, SALEM and CAMEL—were highly ranked among the top ten brands, and VANTAGE continued its phenomenal growth rate.

Tobacco industry analyst John C. Maxwell reported a 28.5 percent gain for VANTAGE, following a 1973 increase of 22.7 percent. The brand moved up two spots in the brand standings to 16th place.

WINSTON, for which Maxwell reported an overall gain of more than two billion units, remained the nation's best-selling cigarette for the ninth consecutive year.

At midyear, the company introduced WINSTON Lights, a lower "tar" and nicotine version of WINSTON, and the new cigarette's sales exceeded forecasts for the last six months of the year. In September, the WINSTON menthol brand was completely reformulated and reintroduced with a new package design.

SALEM, growing at a rate of more than 4 percent in 1974, remained in fifth position. Early in the year, SALEM introduced a box-packed version, and in October, SALEM Extra, an extension of the SALEM line with extra menthol taste, was introduced into test markets in New Orleans and Birmingham.

CAMEL remained in seventh place and continued to dominate the declining market for regular cigarettes.

The CAMEL brand, including CAMEL Regular and CAMEL Filter, showed an overall decline, as the increase posted by CAMEL Filter was offset by the drop in CAMEL Regular sales.

DORAL, another company entry in the lower "tar" and nicotine category, increased sales for 1974 and placed 21st in Maxwell's year-end ranking of brands.

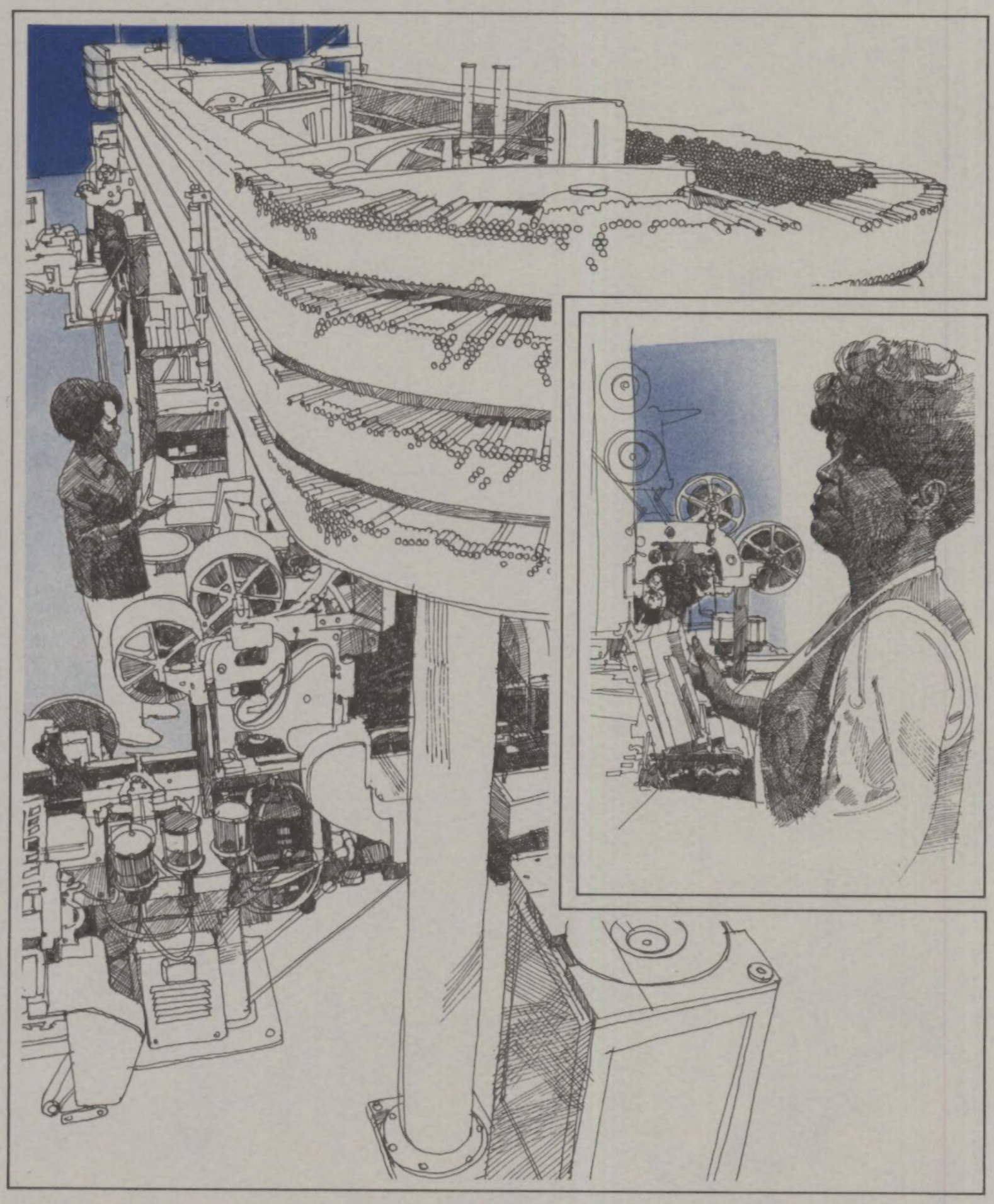
During the year, the company entered test markets with two new cigarette brands—MORE and WINCHESTER.

The MORE brand, tested in Oklahoma City beginning in October, offered the consumer a new concept in cigarette smoking. It is a 120mm, full-flavor, filter cigarette, wrapped in brown paper and styled pencil-thin. It is available in regular and menthol.

MORE's performance in test market was exceptional, and as 1974 ended, the decision was made to expand MORE's markets to New York City and Southern California.

WINCHESTER, available in regular and menthol, is an 85mm, full-flavor, filter cigarette being tested in Dallas, Ft. Worth and Portland. This brand was introduced in October and, at year's end, no decision had been made about entering additional markets.

WINCHESTER little cigars continued to lead the little cigar market by a wide margin.



PRINCE ALBERT continued as the nation's best-selling smoking tobacco, and APPLE pipe tobacco completed its first year in national distribution and is a solid entry in the aromatic blend category. CARTER HALL ranked sixth among all pipe tobaccos. A new brand, ZUR, was introduced into test markets in Albany, Rochester, Dayton and Des Moines as an entry in the growing imported pipe tobacco category.

DAYS WORK led the plug chewing tobacco market, and APPLE plug continued to perform well.

Installation of the new generation of cigarette manufacturing equipment continued on schedule. The new equipment, which greatly increases production of a firmer, more uniform cigarette, is being installed on a four-year schedule to assure that no employees lose their jobs as a result of the new machinery.

The introduction of new brands and brand extensions in 1974 is a result of the ongoing brand development and improvement program at the development center. The life cycle of tobacco products, or any product for that matter, is difficult to predict; therefore, at the development center, studies are always underway to keep the company abreast of the constantly changing tastes of the consumer.

During 1974, R. J. Reynolds Tobacco Company sold about 40 percent more cigarettes in the United States than its nearest competitor, with WINSTON as the sales leader. In other tobacco categories, WINCHESTER little cigars, PRINCE ALBERT smoking tobacco and DAYS WORK plug tobacco gave the company sales leadership in each area of the company's activity within the tobacco industry. □

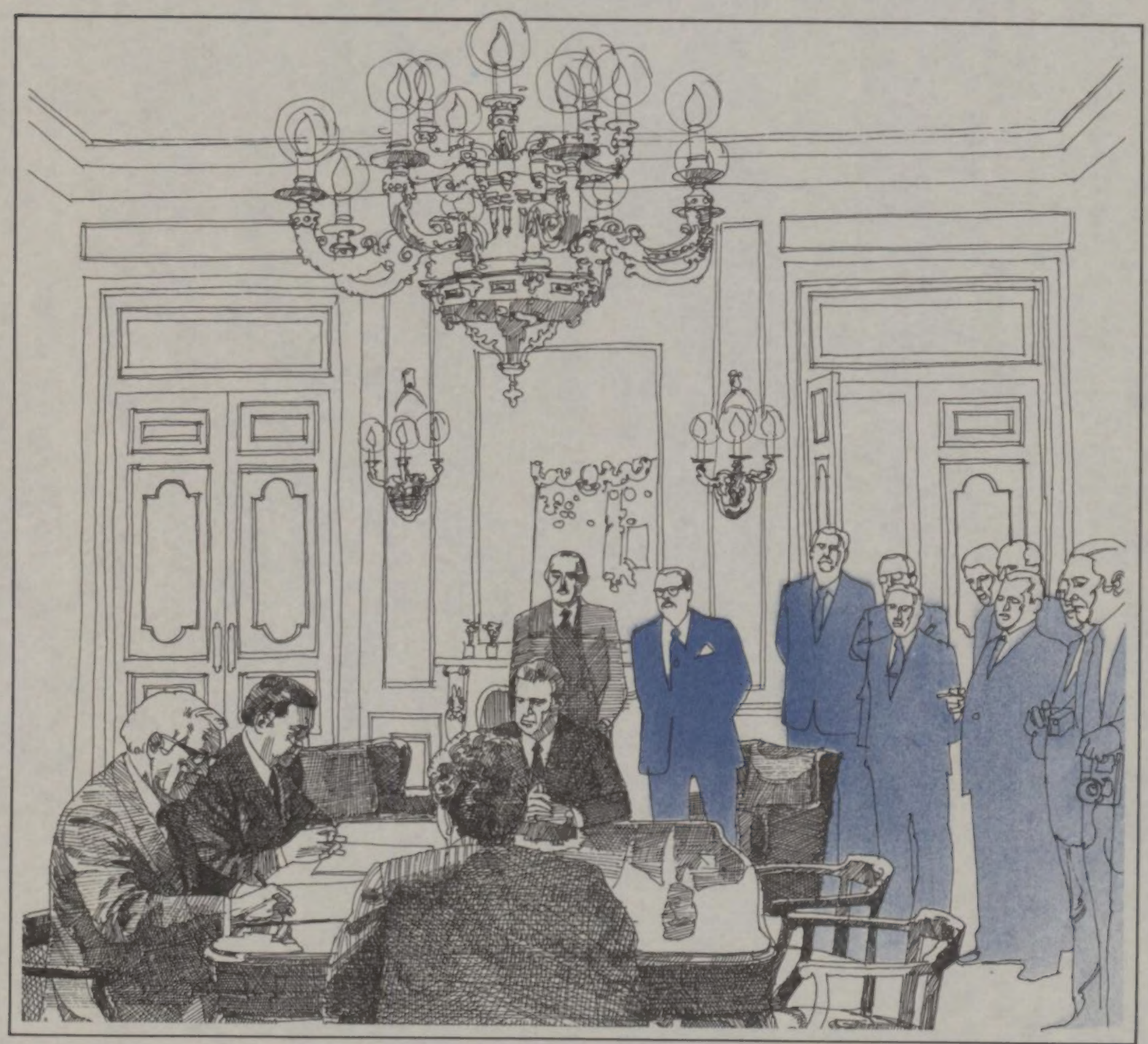
INTERNATIONAL TOBACCO OPERATIONS

Continued expansion of R. J. Reynolds Tobacco International, S.A. and a successful first year for a Canadian subsidiary highlighted international tobacco activities during 1974.

Reynolds International's major achievements were a 20 percent growth in sales and extensions of business in South America and the Far East. Both reflect successful efforts to strengthen the Swiss-based international organization which is responsible for sales and marketing of Reynolds brands in more than 140 countries.

In addition, Reynolds International completed licensing agreements for manufacture of WINSTON in Spain and Greece. At the end of 1974, Reynolds International had agreements for manufacture of the company's brands in nine countries, the others being Austria, East Germany, Iran, Peru, the Philippines, South Vietnam and Yugoslavia.

In Canada, considerable progress was made toward new goals for Macdonald Tobacco Inc., acquired in February. Research and development was expanded significantly and several departments were formed or reorganized to improve the performance of this company.



The national sales office was moved from Toronto to the company's headquarters in Montreal and the sales organization in Canada was expanded.

During the year, Macdonald began production of WINSTON cigarettes, becoming the manufacturer and marketer of the best-selling brands of cigarettes in both the United States and Canada—WINSTON and Macdonald's own EXPORT "A". In addition, Macdonald introduced CAVALIER, a full-flavored 85 mm filter cigarette of 100 percent Virginia-type tobacco, aimed at strengthening Macdonald's position in the fast-growing Canadian market for king-size filters. Test marketing showed initial consumer acceptance of the Canadian-made WINSTON and CAVALIER to be far above that of any other brands introduced in Canada in recent years.

Reynolds International's activities in South America were especially notable in Brazil, Venezuela and Ecuador.

In Brazil, Reynolds acquired two cigarette factories—in Sao Paulo and Campinas—and a tobacco leaf processing plant in Rio Grande do Sul. At the same time, several distribution companies with sales offices in all major cities were acquired and regrouped under the name of R. J. Reynolds Tabacos do Brasil, Ltda.

In Venezuela, a small company in which Reynolds acquired an interest in 1973 has been restructured and the factory upgraded for production of U.S.-type cigarettes. These are important actions, since Venezuelan import taxes make importation of cigarettes prohibitive.

In Ecuador, national distribution was begun in 1974 of WINSTON, SALEM and CAMEL through El Progreso Company, a joint venture of Reynolds and local interests. Sales are developing well.

Other efforts in the South American-Caribbean area included construction of a small plant on the

SEA-LAND SERVICE, INC.

International Tobacco (continued)
island of Curacao. The plant will supply WINSTON and CAMEL brands in the Netherlands Antilles.

Development of business in the Far East and Pacific areas has been equally gratifying.

In West Malaysia, where Reynolds International has acquired a factory in Kuala Lumpur, plant expansion has begun and CAMEL Filter is being manufactured for West Malaysia.

Sales in Indonesia are above expectations, following the first phase of modernization of the company's Indonesian factory and its equipment. Two new local brands, OSCAR Filter and LANCER Filter, have been successfully introduced.

R. J. Reynolds Tobacco (Australia) Pty. Ltd. has developed its sales better than expected, and growth of WINSTON, SALEM and CAMEL was very good in the market segment for imported brands.

In the Philippines, a contract was signed with Fortune Tobacco to make and sell Reynolds' brands there. It is the largest tobacco company in the Philippines.

European business is continuing to grow, with the introduction of local brands designed to fit tastes and needs of local populations. In addition, CAMEL Filter continues to grow at a rate more than double that of the overall market and has strengthened its position in West Germany, France, Switzerland and Holland.

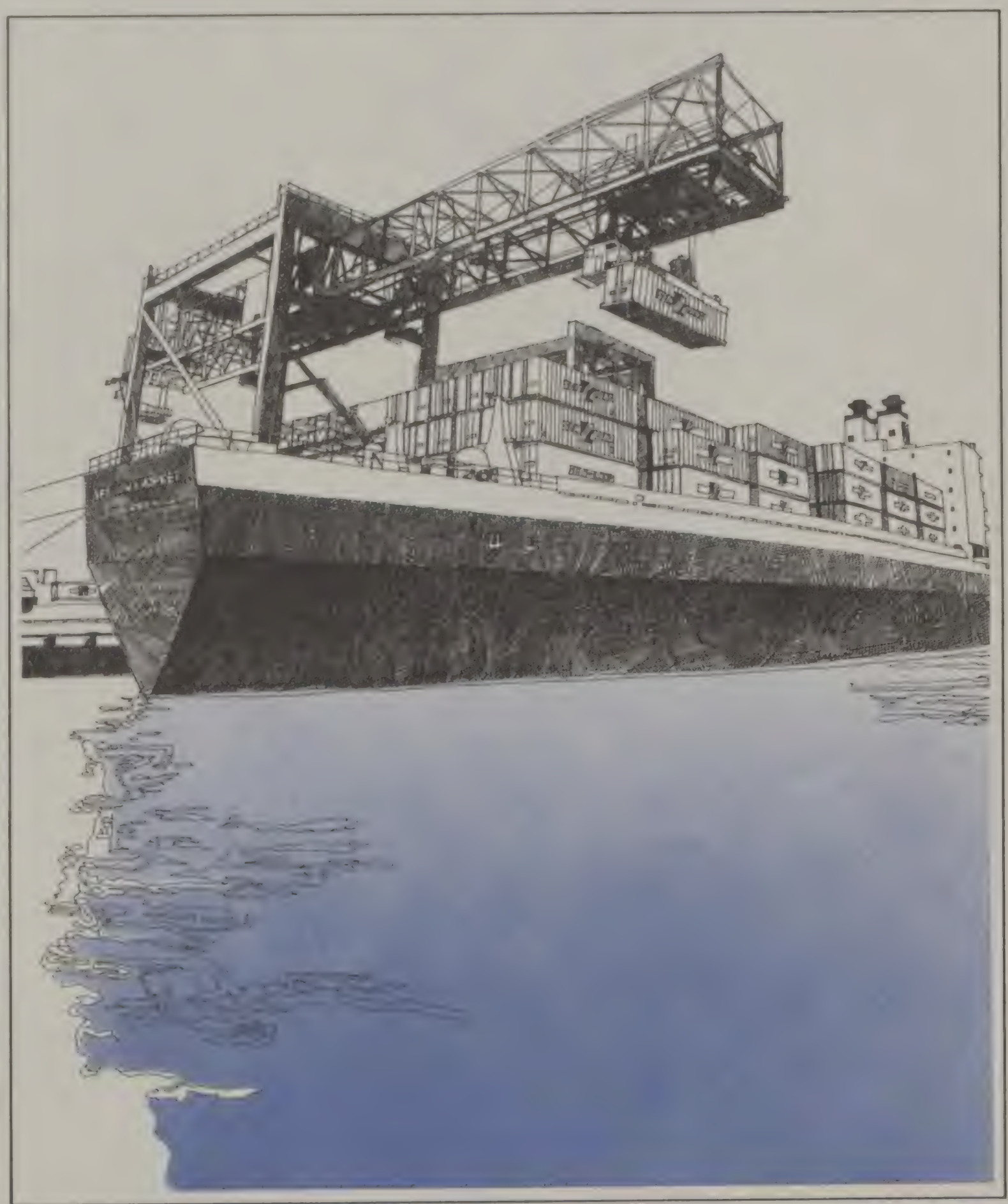
Overall export business of the company's U.S.-made cigarettes is continuing to increase, especially in the Middle East, where WINSTON has a very strong position. □

A year of fulfillment would best characterize 1974 for Sea-Land Service, Inc.

It was the first full year that all eight of the company's SL-7 containerships were available for operation. These ships, the largest of their kind, had been delivered over a 15-month period beginning in late 1972. Expansion and modernization of support facilities continued in 1974. The company has achieved what it had set out to accomplish five years previously, and, as a result, at year end Sea-Land had attained an efficiency of operation far superior to that which it possessed when it became a part of the Company in 1969.

Although the economies of certain markets were depressed—most notably those of Italy, Japan and the United Kingdom—Sea-Land generally operated in very favorable world trade conditions during 1974.

Having firmly established its superiority on major trade routes, Sea-Land is looking toward the development of new business in 1975, particularly in those areas with large buying powers that are adjacent to markets the company already serves. The addition of two



733-container SL-18's between the U. S. Gulf and South Atlantic coasts and northern Europe during the second half of 1974 more than doubled Sea-Land's capacity on that route. Sea-Land now has a total of four SL-18's in its fleet.

During the year, the company also completed expansion of support facilities at the 232-acre port complex at Elizabeth, New Jersey. Most important among these is a 306,-000-square-foot warehouse designed to handle the requirements of customers shipping less than full trailer loads.

Sea-Land and two other companies serving between Puerto Rico and ports on the East and Gulf coasts of the U.S. sold in 1974 their containerized common carrier systems to the Puerto Rico Maritime Shipping Authority, a public corporation created by that Commonwealth's Legislative Assembly. In Sea-Land's case, the transaction included the transfer of five containerships, containers, chassis and certain terminal facilities in Puerto Rico and Elizabeth, New Jersey. In connection with this sale, a subsidiary of the company has concluded a contract with the Authority under which the subsidiary will manage the Authority's containerized freight service (excluding the Authority's "roll-on/ roll-off" operations).

During 1974, Sea-Land continued the fuel conservation program it initiated the preceding year; consequently, its SL-7's operated at speeds slower than their rated 33 knots. The new 1,096-container ships nevertheless were successfully integrated into Sea-Land Service, and the company was able not only to maintain its scheduling superiority but to augment it.

As of year end, the company had more than 65,000 containers in its inventory. In addition to the standard containers used for general cargo, Sea-Land also offers shippers temperature-controlled containers and special containers for transporting automobiles or bulk liquid tanks, among others.

Service was extended to two Caribbean ports during the year—Gustavia, St. Barthelemy, and Road Town, Tortola, Virgin Islands. In addition, the company added over-the-road service to Yokkaichi, Japan. Sea-Land now serves 124 port terminals in 48 countries.

The coming year might be summed up as one of utilization, extension and expansion: utilization of the company's fleet and facilities to the maximum, extension of present routes to embrace nearby markets and, when the opportunity presents itself, expansion into entirely new areas that show potential. □

AMERICAN INDEPENDENT OIL COMPANY

Although there was considerable turmoil in the international petroleum industry, 1974 was a successful year for American Independent Oil Company (Aminoil).

During the early part of the year, oil was in short supply in world markets and demand for the company's oil was strong. Oil became in oversupply during the second half of 1974, as consumption fell considerably below previously anticipated levels. The company, nevertheless, was able to market its full availability of products during the year.

Substantial changes in taxation patterns occurred during 1974 in the petroleum industry. Application of new concession terms by the Organization of Petroleum Exporting Countries (OPEC) caused considerable confusion in the marketplace, leaving future profit levels uncertain at year end.

The company's shipments of petroleum from Kuwait averaged 81,500 barrels per day during 1974. The desulfurizer in Kuwait operated at a record level, with a total of 6.3 million barrels being processed. Aminoil's relations with the government of Kuwait continued to be good throughout the year.

In Iran, as a member of the Iranian Consortium, Aminoil shipped an average of 42,700 barrels per day of crude oil and refined products, principally to Japan.

In addition to seeking new markets, Aminoil expanded considerably its exploration activities in 1974.

At the beginning of the year, the company held interests with partners in two offshore Louisiana tracts, both of which proved to have sufficient natural gas reserves to be developed commercially. Sale of gas from the first discovery is now scheduled to begin the first part of 1976. A production platform will be installed on the other tract this summer, and initial production is expected in the fall of 1976.

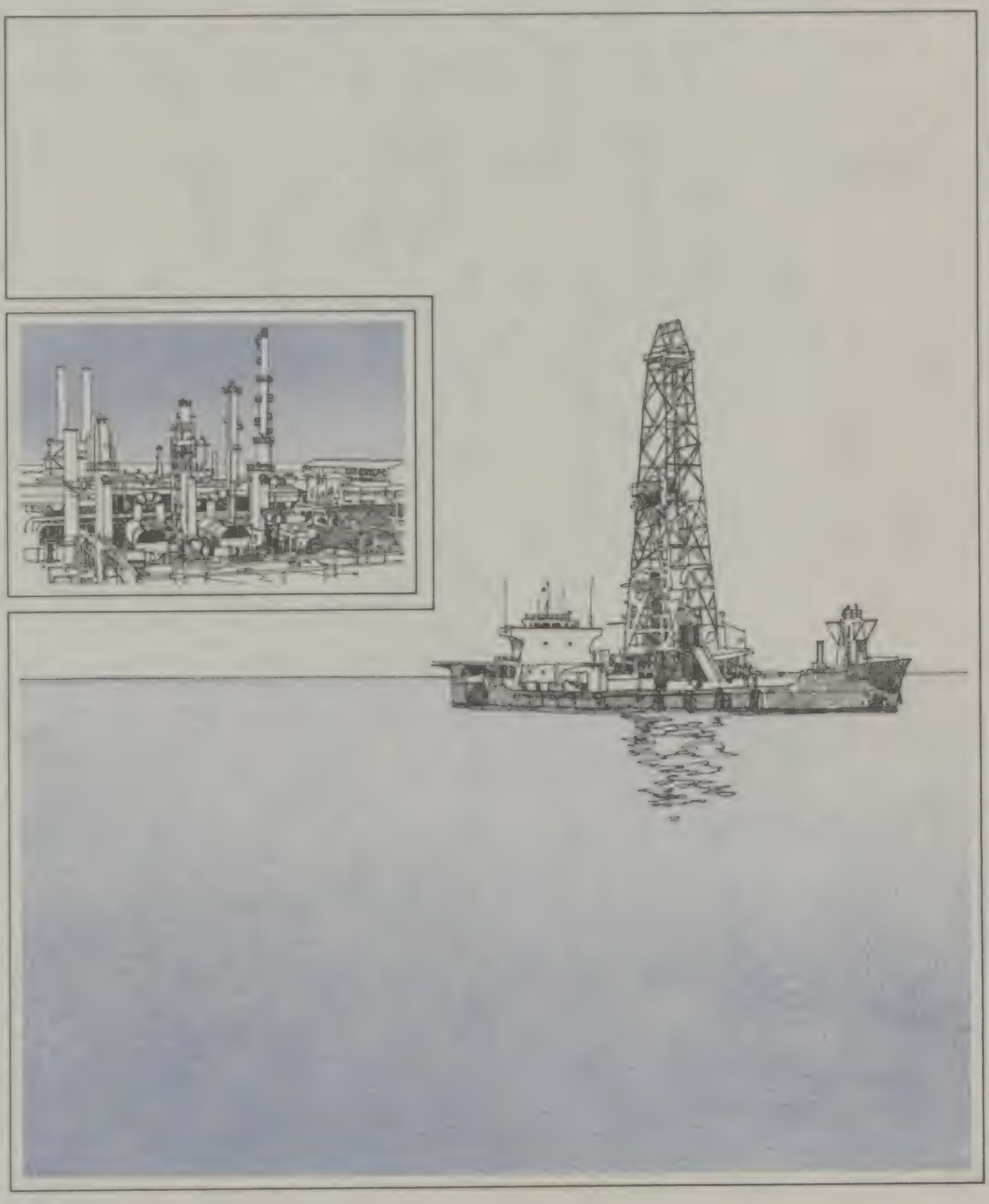
The company obtained interests with partners in 12 additional offshore Louisiana tracts during 1974. At the end of the year drilling was underway on several of these tracts.

To increase the company's participation in U.S. exploration and to handle domestic production, an office has been opened in Houston, Texas. The present staff will be augmented during 1975 to manage increased activities in the United States.

Elsewhere, Aminoil obtained a 20 percent interest in a concession in Paraguay covering five million onshore acres. Seismic work was underway at the close of 1974. Application for an onshore concession was made in Guatemala during the year.

Plans were developed to carry out a seismic survey and drill in Indonesia during 1975.

Aminoil will continue to expand its exploration efforts to seek new sources of petroleum throughout the world, and also will continue to take advantage of marketing opportunities wherever they may arise. Barring unforeseen developments, the company looks forward to a continuing profitable operation in the year ahead. □



RJR FOODS, INC.

Despite difficult conditions in the grocery business, 1974 was a year of record sales for RJR Foods, Inc.

Consumer resistance to escalating costs resulted in reduced shipments in many food categories. However, RJR Foods was able to move counter to many trends, especially in canned fruit punch and frozen Oriental dinners, where all-time high shares-of-market were established.

HAWAIIAN PUNCH fruit punch moved ahead strongly through expansion of the 12-ounce bottling concept into markets now representing 35 percent of the U.S. population. Additionally, distribution of eight-ounce containers was expanded.

The entire line of CHUN KING Oriental foods was reformulated during the year. Major improvements included larger chunks of meat, crisper vegetables and improved sauces. New packaging was developed for every item in the line, and two new items—Pepper Oriental frozen entrees and Pepper Oriental "divider paks"—were successfully introduced.

New products are also coming onstream under the SUNKIST name. Test markets are planned for 1975 under a licensing agreement with Sunkist Growers, Inc.

The reformulated CHUN KING products were also introduced in Canada by RJR Foods, Ltd., the Canadian subsidiary, and the line enjoyed one of its best years ever. In addition, the Canadian company continued to set sales records for SWING Orange Flavour Crystals, an instant-mix beverage. Sales of CORONATION brand pickles, cherries, onions and olives also continued to grow.

In both the United States and Canada, major efforts in value analysis and cost reduction programs offset some of the increased costs. However, it was not possible to absorb all of the increases—sugar prices, for example, went up as much as 300 percent—and the company was forced to pass along to the consumer some of the higher raw material and packaging costs.

In addition to intense attention to cost-control, the company also inaugurated a long-term program for facilities improvement; staffing and restructuring.

Construction began on a 205,000-square-foot manufacturing and distribution facility in South Brunswick, New Jersey. It will manufacture HAWAIIAN PUNCH fruit punch and other products and serve as a distribution center for other RJR Foods' lines. Operations are expected to begin by December, 1975.

The new facility marks the beginning of a major five-year program aimed at consolidating manufacturing and distribution facilities throughout the company. This program will aid in reducing costs and will continue to enable RJR Foods to provide high quality food and beverage products at a reasonable price to consumers.

A number of major management and staff changes were made during the year. Principal among these was the election of J .Tylee Wilson as President and Chief Executive Officer of RJR Foods, Inc.□

RJR ARCHER, INC.

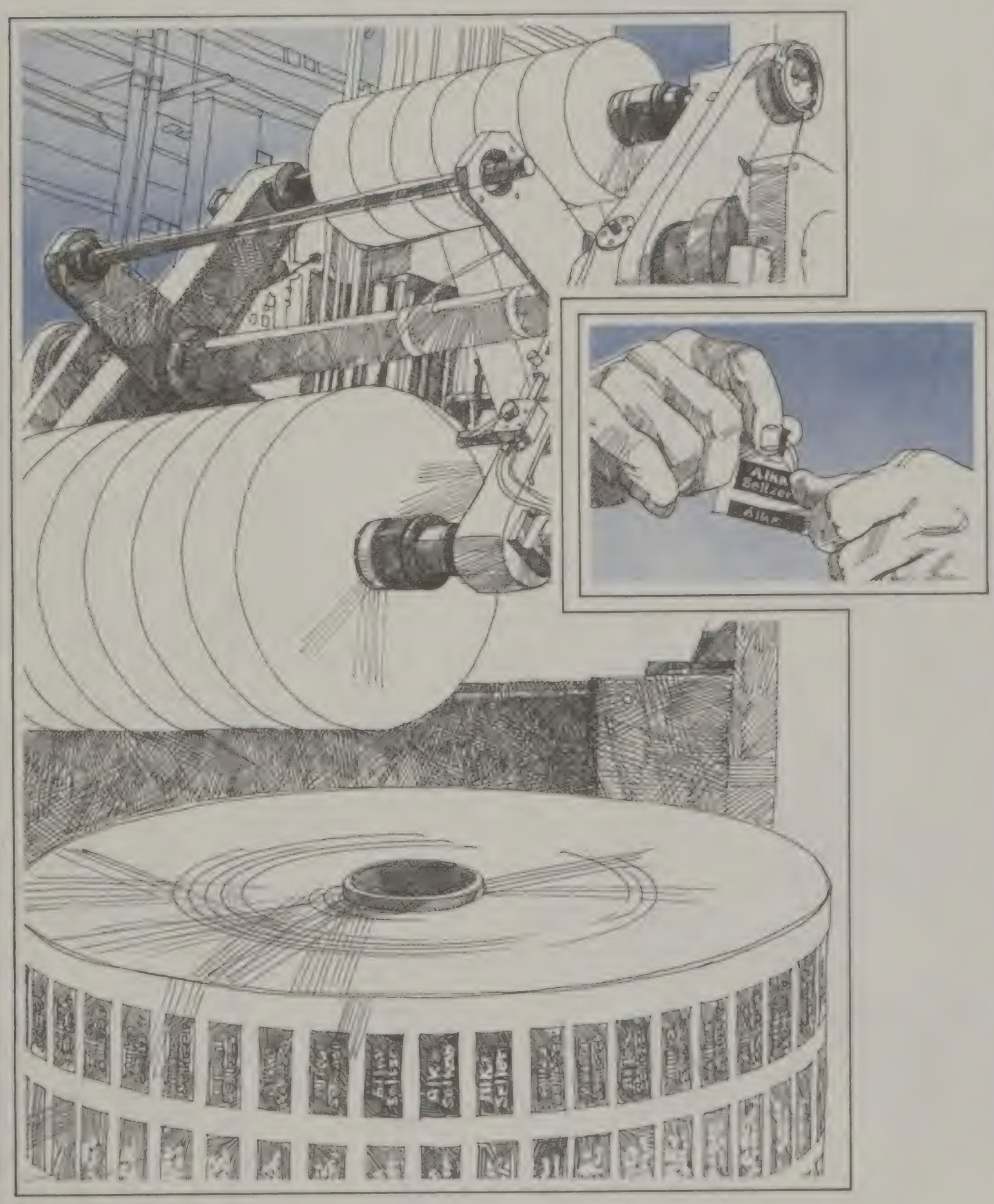
The first half of 1974 was the best six-month period for sales and profits that RJR Archer, Inc. has ever had. Already faced with critical shortages and anticipating more, customers engaged in heavy buying to build up inventories.

By midyear, however, growing uncertainty about the nation's economic condition caused customers to reduce orders dramatically. Nevertheless, Archer's overall 1974 results were good.

During the first six months of the year, the Metals Division operated at full capacity and was forced to turn away customers. But with home building industry suppliers comprising 50 percent of the division's outside customers, business slackened considerably as housing starts declined. This business is expected to pick up by mid-1975 as customers work off inventories and anticipated lower interest rates stimulate construction.

The division's breakthrough with flame-retardant, foil-laminated material shows considerable promise, particularly because of new government safety regulations for the manufacture of bedding, automotive materials, furniture and other products.

During the year, Metals announced plans to build a new $13 million continuous aluminum casting facility at its Huntingdon, Tennessee, plant. Construction will begin early in 1975, with completion scheduled for late 1976.



The Packaging Division made significant gains in sales volume and profits. This success rests on the fact that the division's major market is the tobacco industry, where production and growth have been steady and not affected as much by overall economic conditions.

Packaging did its first significant business in the international tobacco market in 1974 and feels that the potential in that market is considerable. In addition, the division has a number of new flexible packaging products under development with major consumer product companies. The company now supplies packaging for such well-known products as Alka-Seltzer, Kodak film and Sanka coffee.

The Consumer Division had a good year overall, even though major retail variety chain customers slashed orders for gift wrap by 15 to 20 percent after midyear.

The division's soft sculptured foil gift wrap, which utilizes a new process of raised printing, went on the market during 1974 and was well received.

Archer added a new dimension to its consumer product line at the end of 1974 with the acquisition of Artistic, formerly a division of Sun Chemical Corp. Artistic is the largest domestic producer of extruded polypropylene ribbon and bows. This acquisition will provide an additional line of consumer-oriented products which will be marketed with the gift wrap presently manufactured by the Consumer Division.

Filmco, the Archer division that produces clear stretch and shrink films, exceeded 1973 shipments, despite resin shortages. Both the Aurora, Ohio, and the Sedgefield, England, plants operated at near capacity, and business is expected to be even better in 1975. □

FINANCIAL REVIEW

FIVE YEAR CONSOLIDATED SUMMARY OF OPERATIONS
(Dollar Amounts in Thousands Except Per Share Statistics)

	1974	1973	1972	1971	1970
Net sales and revenues:					
Tobacco	$2,895,763	$2,349,617	$2,168,242	$2,084,938	$1,961,817
Transportation	854,780	582,631	450,886	360,656	374,906
Petroleum	461,223	99,989	78,308	71,937	10,126
Other	289,143	262,676	260,194	271,449	293,791
Total	$4,500,909	$3,294,913	$2,957,630	$2,788,980	$2,640,640
Earnings from operations:					
Tobacco	$ 412,585	$ 434,227	$ 404,487	$ 450,683	$ 392,347
Transportation	141,782	16,535	31,688	18,242	38,632
Petroleum	254,072	51,909	35,679	25,687	4,382
Other	15,402	22,139	16,810	19,444	20,949
Total	823,841	524,810	488,664	514,056	456,310
Interest and debt expense	57,530	40,606	30,169	29,694	31,051
Other (income) expense, net	(12,346)	(10,782)	(7,659)	(6,329)	(1,174)
Earnings before provision for income taxes	778,657	494,986	466,154	490,691	426,433
Provision for income taxes	467,959	231,417	234,833	261,626	219,045
Net earnings	310,698	263,569	231,321	229,065	207,388
Less preferred dividends	15,772	15,906	16,580	17,346	18,275
Net earnings applicable to Common Stock	$ 294,926	$ 247,663	$ 214,741	$ 211,719	$ 189,113
Net earnings per common share:					
Primary	$6.99	$5.89	$5.17	$5.18	$4.70
Fully diluted	6.24	5.34	4.61	4.60	4.22
Average number of common shares outstanding:					
Primary	42,188,574	42,064,408	41,547,108	40,907,239	40,242,252
Fully diluted	49,765,082	49,321,395	50,140,565	49,780,139	49,188,427

Consolidated net sales and revenues in 1974 increased $1.2 billion, or 37 percent, over 1973 to a record $4.5 billion. Net earnings for 1974 were $311 million, an increase of $47 million, or 18 percent, over 1973. Primary net earnings per common share increased $1.10 to $6.99 in 1974 (fully diluted earnings per common share increased 90 cents over 1973 to $6.24).

The 1974 results reflect the adoption late in the year of the last-in, first-out (LIFO) method for valuing certain inventories of the foods and aluminum products and packaging subsidiaries. The LIFO change did not have a material effect on 1974 consolidated net earnings.

The year 1973 produced net sales and revenues and net earnings gains of $337 million, or 11 percent, and $32 million, or 14 percent, respectively. Primary earnings per common share in 1973 increased 72 cents, or 14 percent, over 1972 (fully diluted earnings per common share were $5.34 in 1973, an increase of 73 cents, or 16 percent, over 1972).

Over the past five years, net sales and revenues and net earnings have increased at average annual compound rates of 14 percent and 12 percent, respectively.

Consolidated earnings from operations increased $299 million, or 57 percent, in 1974 and $36 million, or 7 percent, in 1973 compared with the preceding year. (Earnings from operations are earnings before interest and debt expense, other income and expense and provision for income taxes.)

The percentage contribution of each of the Company's lines of business to total net sales and revenues and earnings from operations for each of the years 1970-1974 is shown in the following table:

Net Sales and Revenues

	1974	1973	1972	1971	1970
Tobacco	64.3%	71.3%	73.3%	74.8%	74.3%
Transportation	19.0	17.7	15.2	12.9	14.2
Petroleum	10.3	3.0	2.7	2.6	0.4
Other	6.4	8.0	8.8	9.7	11.1
	100.0%	100.0%	100.0%	100.0%	100.0%

Earnings From Operations

	1974	1973	1972	1971	1970
Tobacco	50.1%	82.7%	82.8%	87.7%	86.0%
Transportation	17.2	3.2	6.5	3.5	8.5
Petroleum	30.8	9.9	7.3	5.0	0.9
Other	1.9	4.2	3.4	3.8	4.6
	100.0%	100.0%	100.0%	100.0%	100.0%

The sales and revenues of the Company's non-tobacco business have grown from 26 percent of consolidated sales and revenues in 1970 to 36 percent in 1974.

Tobacco

Over the past five years tobacco sales and earnings from operations have increased at average annual compound rates of 10 percent and 5 percent, respectively.

On February 15, 1974, the Company acquired for $75 million the stock of Macdonald Tobacco Inc., a Canadian manufacturer and distributor of cigarettes, smoking tobacco and cigars. The purchase was effective January 1, 1974, and the accounts of Macdonald are therefore included in the consolidated statements from that date. The pro forma effect of this acquisition on 1973 results is presented in Note H to the financial statements.

Tobacco sales were $2.9 billion in 1974, an increase of 23 percent over 1973's $2.35 billion. The 23 percent increase reflects the acquisition of Macdonald Tobacco, which accounted for 11 percent; worldwide unit volume increases, 6 percent; and higher selling prices worldwide, 6 percent. Tobacco earnings from operations declined to $413 million in 1974 from $434 million in 1973. The decline is attributable to substantially higher operating costs, including costs related to the increased level of development and introduction of new brands, and a 23 percent rise in leaf tobacco purchase prices, which more than offset the effect of revenue gains. Since 1956 the Company has valued its tobacco inventories using the LIFO method, thereby charging increased leaf tobacco costs against earnings immediately rather than deferring them to later periods.

Tobacco sales for 1973 were $2.35 billion, up $181 million, or 8 percent, over 1972 and earnings from operations were $434 million, up $30 million, or 7 percent, over the prior year.

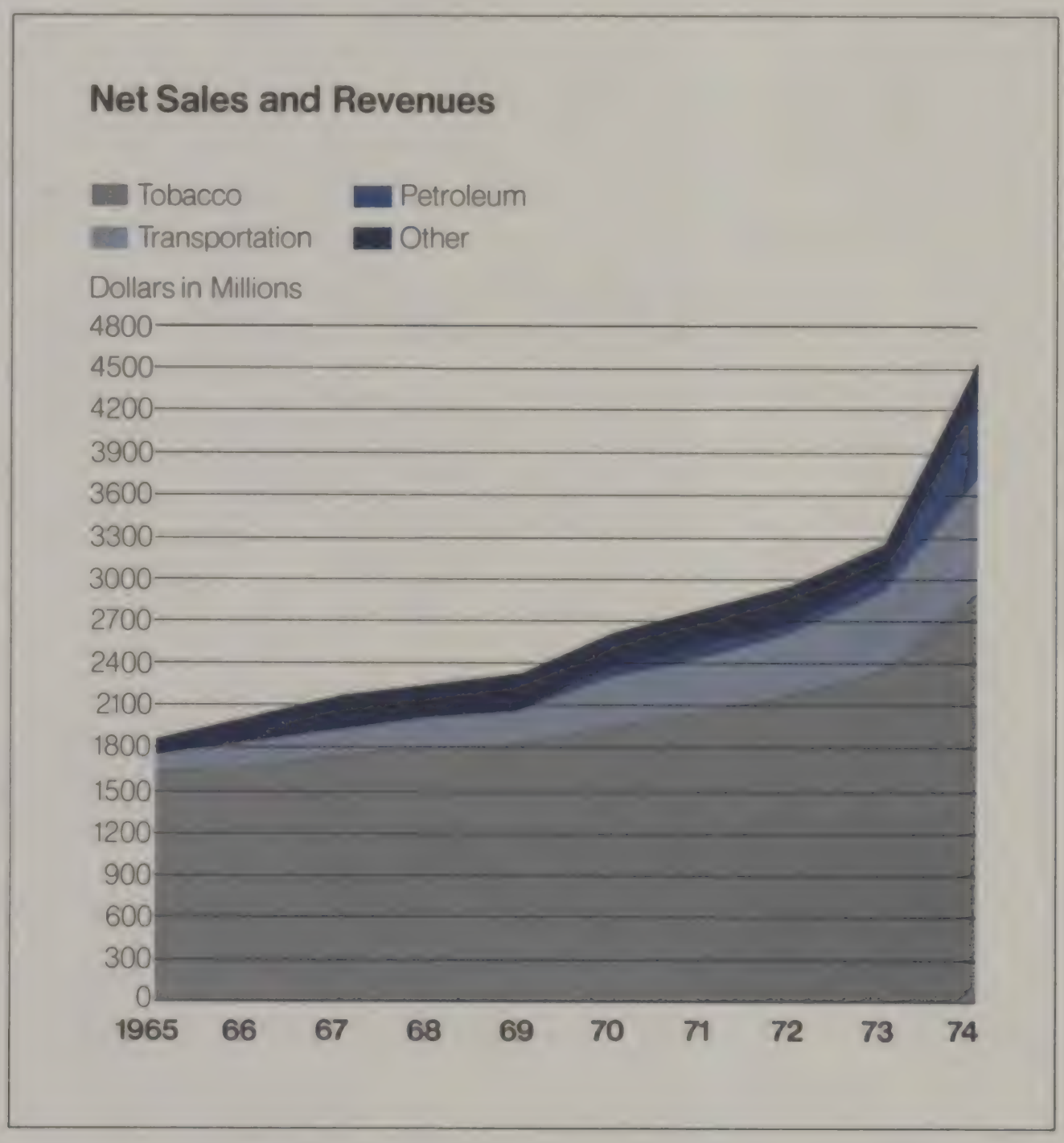
Transportation

During the past five years, transportation revenues and earnings from operations have increased at average annual compound rates of 25 percent and 20 percent, respectively.

In 1974, transportation revenues were $855 million, an increase of $272 million, or 47 percent, over 1973. Earnings from operations reached $142 million, an increase of $125 million over the prior year. Approximately two-thirds of the revenue increase can be attributed to generally favorable world trade conditions, better balanced trade volumes and improved rates on certain trade routes. The remainder of the increase resulted from the greater capacity of the expanded fleet. Additions to the fleet included two new 23-knot SL-18 vessels (733 containers each), which were placed in service during the last half of 1974, and the eight new SL-7 containerships (each with a 1,096 container capacity and a cruising speed of up to 33 knots), of which two entered service late in 1972 and six at various dates during 1973.

The earnings increases reflect the higher 1974 revenues, better operating performance, and lower redeployment and start-up costs compared with 1973. Principal cost increases for the year were bunker fuel, up $59 million; maintenance and repairs, up $18 million; lease expense, up $10 million; and depreciation of vessels and related equipment, up $12 million. These additional expenses reflect generally higher prices (especially with respect to bunker fuel, which quadrupled in price during 1974) and additional costs required to support the expanded level of operations in 1974.

Transportation revenues in 1973 reached $583 million, an increase of $132 million, or 29 percent, over 1972. Earnings from operations declined $15 million during the same period. The revenue increases in



1973 resulted primarily from the increased capacity of the six SL-7 containerships phased into service during the year. The earnings decline in 1973 resulted almost entirely from the redeployment and heavy start-up expenditures incurred as the new vessels were phased into the fleet. Increases in depreciation, lease, and maintenance and repairs expense aggregating $56 million also affected 1973 earnings from operations.

Effective September 30, 1974, the Company sold to the Puerto Rico Maritime Shipping Authority the part of its transportation business which provided service between Puerto Rico and the East and Gulf Coasts of the United States. The sales price of $83 million was approximately equal to the book value of the business sold. This service contributed approximately $85 million to 1974 sales and revenues during the nine months prior to the sale and $95 million to 1973 sales and revenues. Interest income on the proceeds from the sale and management fees accruing to the Company under a related contract are expected to approximate the earnings that would have been realized from this business. The Company anticipates the sale will have no material effect on future earnings.

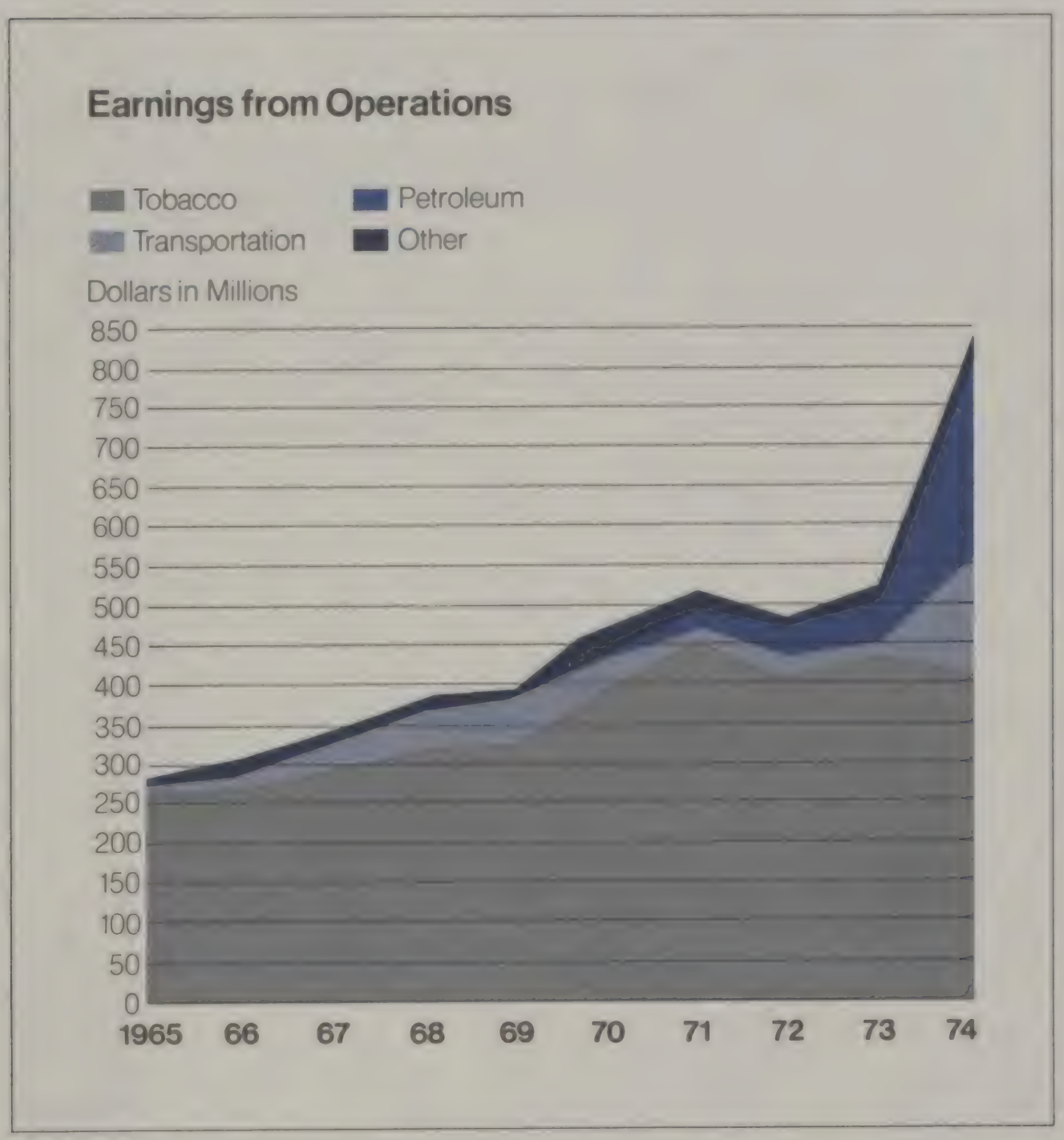
Petroleum

Reynolds entered the petroleum business with the acquisition of American Independent Oil Company in September, 1970. Sales by the petroleum business reached $461 million in 1974, an increase of $361 million, and earnings from petroleum operations amounted to $254 million, up $202 million over 1973. Almost all of the revenue and earnings from operations increases resulted from the quadrupling of posted prices announced by members of the Organization of Petroleum Exporting Countries (OPEC) late in 1973. The 1974 earnings from operations increase was largely absorbed by additional taxes payable to the OPEC member states in which the Company's investments are located.

Petroleum sales and revenues reached $100 million in 1973, an increase of $22 million, or 28 percent, over 1972 and earnings from operations increased to $52 million, $16 million higher than the 1972 amount. The increases in sales and earnings were primarily attributable to price increases by OPEC member states, and earnings from operations increases were largely offset by higher foreign taxes on those earnings.

Other Businesses

Sales by the Company's other businesses (foods and aluminum products and packaging) increased in 1974 to $289 million, up $26 million, or 10 percent, over 1973 and earnings from operations declined to $15 million, down $7 million from the prior year. The sales increases



resulted primarily from higher food prices and price and volume increases in the aluminum products and packaging businesses. The decline in earnings from operations was due in large part to the Company's adoption of the LIFO method for valuing certain inventories (principally aluminum and sugar) of these businesses which reduced earnings from operations by $15.6 million in 1974. The LIFO method was adopted to reflect currently the effect of increasing raw material prices on operating results.

Sales by the Company's other businesses in 1973 increased to $262 million, $2 million higher than the previous year, and earnings from operations increased to $22 million, up $5 million over 1972. The earnings increase of 32 percent was due principally to improved sales and the elimination of some unprofitable lines in the foods business.

Sales and revenues of the Company's other businesses declined in 1971 and 1972 when compared to 1970 due to the May, 1971, sale of the Company's corn processing business, Penick and Ford, Limited.

Interest and Debt Expense

Interest and debt expense was $58 million in 1974, $41 million in 1973 and $30 million in 1972, reflecting several factors. The 1974 amount includes a full year's interest on the long-term ship mortgage bonds issued in conjunction with delivery of the eight new SL-7 containerships late in 1972 and at various dates in 1973. Average short-term debt balances and effective borrowing rates were higher in 1974 and 1973 than in 1972 (effective rates were 10 percent in 1974 and 6.5 percent in 1973, compared to 5.0 percent in 1972).

Between 1969 and 1973 the Company capitalized as SL-7 vessel cost $28 million of construction loan interest and commitment fees, including $8 million in 1973 and $11 million in 1972.

Provision for Income Taxes

The Company's provision for income taxes in 1974 was 60 percent of earnings before taxes, compared to 47 percent in 1973 and 50 percent in 1972.

The higher effective rate in 1974 is due principally to substantially higher taxes in that year on international petroleum earnings.

In addition, investment tax credits in 1974 amounted to less than $6 million, compared to $30 million in 1973 and $10 million in 1972. The Company uses the flow-through method in accounting for investment tax credits, whereby the provision for income taxes is reduced in the year the credit first becomes available. The 1973 and 1972 investment tax credit amounts reflect the higher capital expenditures in those years, primarily in relation to the SL-7 containership program.

Additional analysis of income taxes is contained in Note F to the financial statements.

Capital Expenditures

Capital expenditures in 1974 were $126 million, compared to $340 million and $253 million in 1973 and 1972, respectively. Expenditures to complete two new SL-18 type vessels constructed in United States shipyards and additional equipment to support the expanded fleet accounted for $63 million of the 1974 amount.

During the past year $54 million was expended in the tobacco business for replacement and modernization of existing equipment and facilities throughout the world.

During the past five years, capital expenditures have totaled $1.1 billion. More than half of these outlays were financed with funds generated from internal sources. Capital expenditures in 1974 were financed almost totally with internally generated funds.

Capital expenditures in 1975 are currently estimated at $200 million.

Debt Position

Long-term debt (including current maturities) at year end amounted to $489 million. Repayments of $91 million during the year included $50 million for the retirement of the 8⅛% Notes and $7 million for purchase of 7⅞% Debentures for future sinking fund requirements. Payments on ship mortgage bonds during 1974 were $25 million, reducing total ship mortgage bonds at year end to $242 million. Additional information on long-term debt is contained in Note B to the financial statements.

Short-term notes at year end were $158 million, up from $47 million a year ago. This increase was due principally to the acquisition of Macdonald Tobacco Inc. and the seasonal purchase of leaf tobacco.

The Company's total debt as a percentage of total capital (the sum of stockholders' equity, long-term debt, and notes payable) decreased from 29 percent in 1973 to 28 percent at year end 1974, reflecting the increased use of internal sources of capital. Total debt as a percentage of total capital has averaged 29 percent for the last five years.

Dividends

The Company increased the quarterly dividend on the Common Stock from 67 cents per share to 72 cents per share for the fourth quarter of 1974. The Company's dividend payment per common share has increased each year for the past 21 years except for 1971, when dividend increases were prohibited by federal economic guidelines.

For the past five years dividends per common share have averaged 46 percent of earnings per common share before extraordinary items. Dividends declared on the Common and Preferred Stocks during 1974 totaled $131 million, the highest for the Company's 75 consecutive years of dividend payments.

The Company has paid the regular quarterly dividend of 56.25 cents per share on its $2.25 Convertible Preferred Stock for each quarter since the issue of that stock in May, 1969. The following table sets forth the dividends paid per share of Common Stock during 1973 and 1974.

Quarter	1974	1973
First	$ .67	$ .648
Second	.67	.648
Third	.67	.67
Fourth	.72	.67
Year	$2.73	$2.636

Stock Prices

The high and low sales prices of the Common and Preferred Stocks on the New York Stock Exchange were as follows during 1974 and 1973:

1974	Common		Preferred	
Quarter	High	Low	High	Low
First	49⅞	39¼	52½	37¾
Second	48	39¾	49	40¼
Third	46⅞	39¾	48⅛	37¾
Fourth	53⅜	37¼	57¾	35¼
Year	53⅜	37¼	57¾	35¼

1973	Common		Preferred	
Quarter	High	Low	High	Low
First	55¾	44¾	61	48¾
Second	47	41	49¼	40½
Third	52⅝	42⅞	57½	44¼
Fourth	48½	36½	50½	35
Year	55¾	36½	61	35

SELECTED FIVE YEAR INFORMATION

(Dollar Amounts in Thousands Except Share Statistics) Year Ended December 31

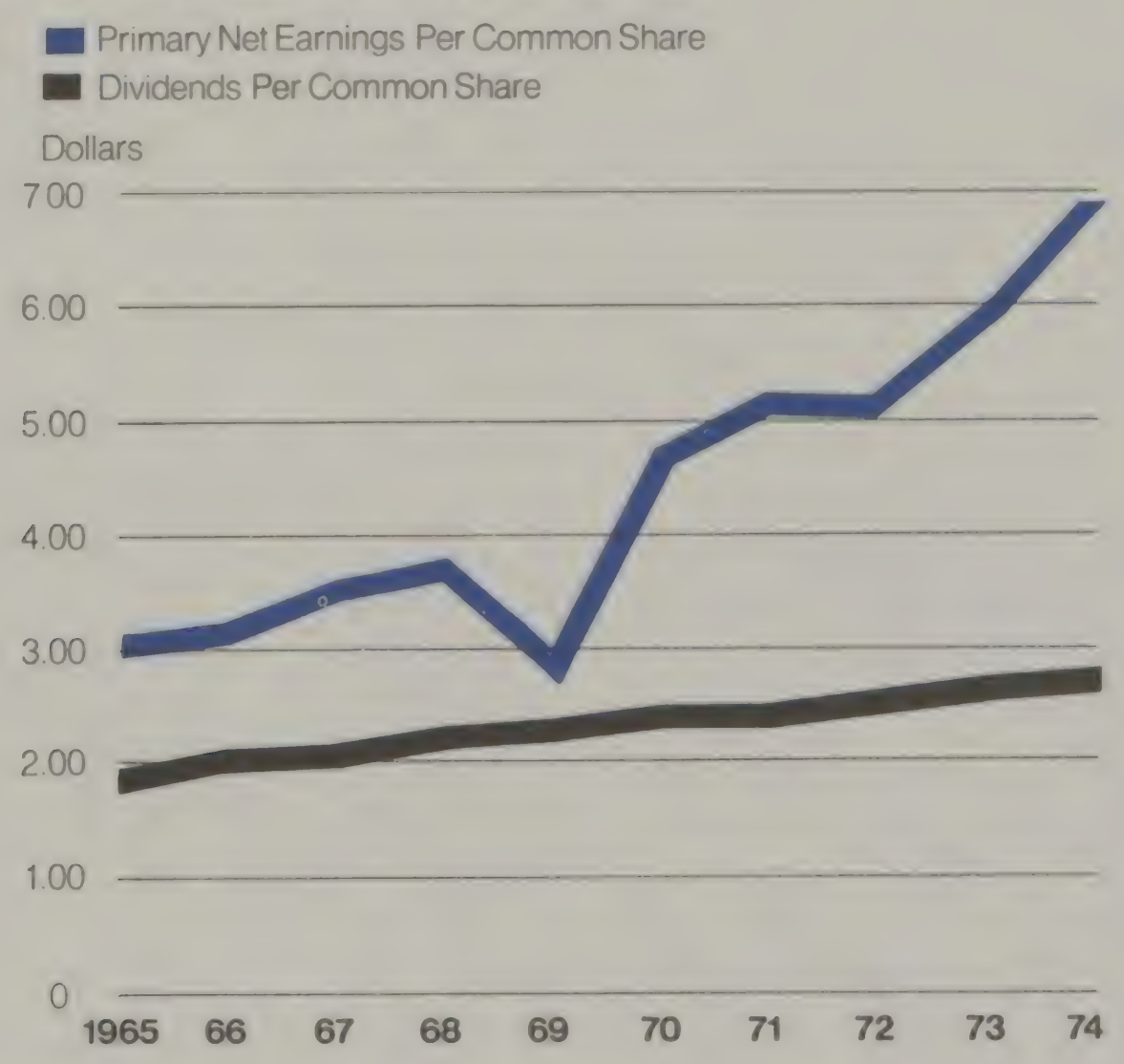
	1974	1973	1972	1971	1970
Total current assets	$1,559,189	$1,146,228	$1,144,349	$1,059,459	$ 954,163
Total current liabilities	731,382	425,755	464,279	311,805	365,937
Working capital	827,807	720,473	680,070	747,654	588,226
Current assets/current liabilities	2.1	2.7	2.5	3.4	2.6
Net property, plant and equipment	$1,183,633	$1,194,562	$ 942,203	$ 758,013	$ 690,768
Total assets	3,126,074	2,611,993	2,344,026	2,055,504	1,908,663
Return on average total assets (1)	11.8%	11.5%	11.2%	12.3%	12.3%
Notes payable	$ 157,683	$ 46,926	$ 12,455	$ 17,416	$ 148,746
Long-term debt (including current maturities)	489,174	563,335	537,572	470,357	340,579
Stockholders' equity	1,696,810	1,512,183	1,370,661	1,247,200	1,118,041
Total capital	2,343,667	2,122,444	1,920,688	1,734,973	1,607,366
Return on average total capital (2)	15.2%	14.5%	14.4%	15.2%	14.7%
Capital expenditures	$ 125,832	$ 339,729	$ 252,885	$ 166,499	$ 177,537
Depreciation, depletion and amortization	116,905	86,800	70,471	68,439	62,275
Cash flow from operations	473,401	400,030	345,261	323,177	292,546
Dividends on Common and Preferred Stocks	$ 130,964	$ 126,833	$ 120,304	$ 115,636	$ 114,859
Dividends per common share	2.73	2.636	2.496	2.40	2.40
Dividend payout ratio (3)	39%	45%	48%	46%	51%
Common Stock price range—High	53⅜	55¾	78	69½	55⅜
Low	37¼	36½	47¾	50¼	34⅜
Net earnings as a percent of net sales and revenues	6.9%	8.0%	7.8%	8.2%	7.9%
Return on average common stockholders' equity	19.3%	18.1%	17.4%	19.3%	19.2%
Book value per common share	$ 38.27	$ 34.13	$ 30.91	$ 28.33	$ 25.62
Number of stockholders at year-end	125,176	124,371	120,321	126,790	137,504
Number of employees at year-end	32,454	31,477	30,042	29,484	28,255

(1) Net earnings plus after-tax interest and debt expense divided by average total assets.

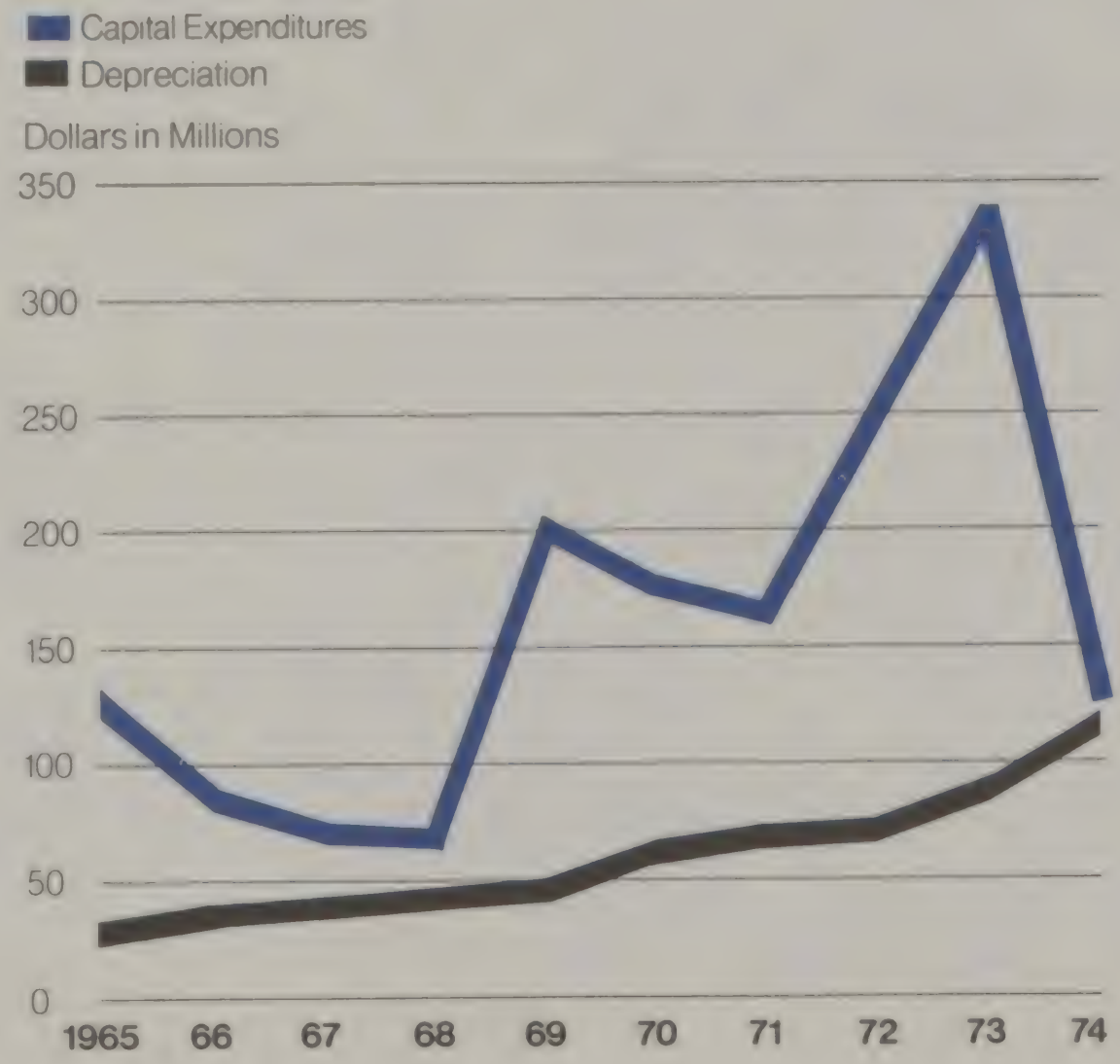
(2) Net earnings plus after-tax interest and debt expense divided by average total capital, excluding vessel construction loans. (Total capital is the sum of stockholders' equity, short-term notes payable, and total long-term debt.)

(3) Dividends per common share as a percentage of primary earnings per common share.

Net Earnings Per Common Share and Dividends Per Common Share



Capital Expenditures and Depreciation



R. J. REYNOLDS INDUSTRIES, INC.

CONSOLIDATED BALANCE SHEETS

December 31, 1974 and 1973 (Dollars in Thousands)

ASSETS	1974	1973
Current assets:		
Cash	$ 42,442	$ 36,041
Marketable securities (approximate market)	254	3,655
Accounts and notes receivable (less allowances of $15,043 and $14,941,respectively)	367,085	259,354
Inventories	1,134,969	835,318
Prepaid expenses	14,439	11,860
Total current assets	1,559,189	1,146,228
Property, plant and equipment—at cost:		
Land and land improvements	19,099	15,796
Buildings and leasehold improvements	185,434	169,119
Machinery and equipment	365,939	307,454
Vessels, containers and other marine equipment	1,106,973	1,125,030
Petroleum-producing properties	95,992	94,262
Construction-in-process	45,351	56,817
	1,818,788	1,768,478
Less allowances for depreciation, depletion and amortization	635,155	573,916
Net property, plant and equipment	1,183,633	1,194,562
Cost in excess of net assets of businesses acquired	174,224	163,214
Other assets and deferred charges	209,028	107,989
	$3,126,074	$2,611,993

See Notes to Consolidated Financial Statements.

LIABILITIES AND STOCKHOLDERS' EQUITY	1974	1973
Current liabilities:		
Notes payable	$ 157,683	$ 46,926
Accounts payable and accrued accounts	296,095	218,325
Current maturities of long-term debt	33,811	84,153
Income taxes accrued	243,793	76,351
Total current liabilities	731,382	425,755
Long-term debt (less current maturities)	455,363	479,182
Other non-current liabilities	77,820	53,082
Deferred income taxes	164,699	141,791
Stockholders' equity:		
Preferred Stock—$2.25 Convertible Preferred Stock—without par value Authorized 6,856,312 shares in 1974; issued—6,844,362 shares in 1974 and 7,066,759 shares in 1973	72,345	74,696
Common Stock—Par $5 Authorized—60,000,000 shares; issued—42,446,722 shares in 1974 and 42,113,127 shares in 1973	212,234	210,565
Paid-in capital	50,906	45,331
Earnings retained	1,361,325	1,181,591
Total stockholders' equity	1,696,810	1,512,183
	$3,126,074	$2,611,993

See Notes to Consolidated Financial Statements.

R. J. REYNOLDS INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF EARNINGS

For the Years Ended December 31, 1974 and 1973 (Dollars in Thousands)

	1974	1973
Net sales and revenues	$ 4,500,909	$ 3,294,913
Costs and expenses:		
Cost of products sold and operating expenses	3,199,191	2,413,051
Selling, advertising, administrative and general expenses	477,877	357,052
Earnings from operations	823,841	524,810
Interest and debt expense (less interest capitalized of $8,000 in 1973)	57,530	40,606
Other (income) expense, net	(12,346)	(10,782)
Earnings before provision for income taxes	778,657	494,986
Provision for income taxes	467,959	231,417
Net earnings	310,698	263,569
Preferred dividends	15,772	15,906
Net earnings applicable to Common Stock	$ 294,926	$ 247,663
Net earnings per common share:		
Primary	$6.99	$5.89
Fully diluted	6.24	5.34
Average number of common shares outstanding:		
Primary	42,188,574	42,064,408
Fully diluted	49,765,082	49,321,395

R. J. REYNOLDS INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF EARNINGS RETAINED

For the Years Ended December 31, 1974 and 1973 (Dollars in Thousands)

	1974	1973
Balance at beginning of year	$1,181,591	$1,044,855
Add net earnings	310,698	263,569
Deduct cash dividends:		
$2.25 Convertible Preferred Stock	15,772	15,906
Common Stock	115,192	110,927
Total cash dividends	130,964	126,833
Balance at end of year	$1,361,325	$1,181,591

See Notes to Consolidated Financial Statements.

R. J. REYNOLDS INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

For the Years Ended December 31, 1974 and 1973 (Dollars in Thousands)

	1974	1973
Working capital was provided by:		
Net earnings	$310,698	$263,569
Add items not involving working capital in the current period:		
Depreciation, depletion and amortization	116,905	86,800
Deferred income taxes	22,908	42,818
Other	22,890	6,843
Total from operations	473,401	400,030
Proceeds from long-term debt	16,441	216,408
Proceeds from issuance of Company's stocks	7,244	6,301
Sale of certain transportation operations:		
Property, plant and equipment	61,764	—
Carrying value of cost in excess of net assets attributable to operations sold	15,000	—
Long-term portion of notes received in exchange	(66,923)	—
Net decrease in long-term assets	9,841	—
Other disposals of property, plant and equipment	4,289	5,042
	511,216	627,781
Working capital was used for:		
Capital expenditures	125,832	339,729
Cash dividends	130,964	126,833
Long-term debt becoming currently payable	40,677	101,100
Retirement of Preferred Stock upon conversion	2,351	1,515
Acquisition of Macdonald Tobacco Inc.:		
Property, plant and equipment	22,628	—
Other assets	92,231	—
Liabilities assumed	(64,350)	—
Cost in excess of net assets acquired	24,136	—
Total acquisition cost	74,645	—
Less working capital at date of acquisition	25,599	—
Net increase in long-term assets	49,046	—
Other (principally other assets and deferred charges)	55,012	18,201
	403,882	587,378
Increase in working capital	$107,334	$ 40,403
Analysis of changes in working capital:		
Increase (decrease) in current assets:		
Cash and marketable securities	$ 3,000	$ (36,412)
Accounts and notes receivable	107,731	32,782
Inventories	299,651	1,401
Prepaid expenses	2,579	4,108
Decrease (increase) in current liabilities:		
Notes payable	(110,757)	(34,471)
Accounts payable and accrued accounts	(77,770)	8,005
Current maturities of long-term debt	50,342	89,545
Income taxes accrued	(167,442)	(24,555)
Increase in working capital	$107,334	$ 40,403

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A— SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation
The Company includes in its consolidated financial statements the accounts of the parent and all subsidiaries.

Foreign Currency Translation and Foreign Operations
Current assets (other than leaf tobacco inventories) and current liabilities denominated in foreign currencies are translated at year-end exchange rates; other assets and liabilities are translated at the rate existing when the asset was acquired or the liability incurred. Long-term ship mortgage bonds, which are payable in foreign currencies, were recorded at the U. S. Dollar equivalent of the bonds at their issue date. Differences between U. S. Dollars required for the principal payments and the recorded bond amount are charged or credited to other (income) expense, net. Foreign currency revenues and expenses were translated at average exchange rates during the year, except that depreciation, depletion and amortization and leaf tobacco costs were translated at the exchange rates in effect on the dates the related assets were acquired. Cumulative net losses resulting from foreign currency translation are expensed and cumulative net translation gains are deferred.

At December 31, 1974, the cumulative net deferred translation gains amounted to $5 million. During 1974, the Company had net translation gains of $4 million which were deferred, and in 1973 translation gains of $2 million of which $1 million was credited to other (income) expense, net and the remaining $1 million was deferred.

At December 31, 1974, the U. S. Dollar equivalent of ship mortgage bonds would have been $34 million greater if translated at year-end rates rather than at the rates in effect on date of issue.

The Company's foreign operations are summarized as follows:

	(Dollars in Thousands)	
	1974	1973
Assets	$ 490,620	$270,623
Liabilities	374,443	144,382
Net sales and revenues	1,201,943	460,152
Earnings from operations	270,265	71,886
Net earnings	61,242	28,701

Inventories
Inventories, principally leaf tobacco, but including supplies and manufactured products, are stated at cost (most of which are valued using the last-in, first-out method). During 1974, the Company extended the use of the LIFO method for valuing inventories to include certain inventories of its foods and aluminum products and packaging businesses (principally sugar and aluminum), which had the effect of reducing earnings from operations by $15.6 million for the year. The LIFO method was adopted in order to reflect currently the effect of increasing raw material prices on operating results. The change had no material effect on consolidated net earnings.

The current replacement value of inventories at December 31, 1974 and 1973 was approximately $476 million and $287 million, respectively, greater than the amount at which these inventories were carried on the balance sheet.

Depreciation
The Company depreciates assets used in the transportation and petroleum businesses using the straight-line method. For all other assets, depreciation is determined principally by accelerated methods. Renewals, conversions or betterments which add materially to the value or useful lives are charged to property, plant and equipment accounts or to their respective depreciation allowance accounts.

Interest Expense
The Company capitalized, as vessel cost, $28 million of construction loan interest and commitment fees incurred during the five-year construction period (1969-1973) of the SL-7 containerships. Of this amount, $8 million was capitalized in 1973.

Investment Tax Credit
The Company uses the flow-through method in accounting for investment tax credits, whereby the provision for income taxes is reduced in the year the tax credits first become available, rather than deferring the credit over the life of the related asset.

Earnings Per Share
Primary earnings per share are determined by dividing net earnings applicable to Common Stock by the average number of common shares and equivalent common shares outstanding.

Fully diluted earnings per share are calculated using the "treasury stock" method. This method assumes that all shares of the Preferred Stock outstanding during the year (plus shares of the Preferred

Stock which would have been issued assuming exercise of substitute options) were converted into Common Stock and the proceeds used to purchase treasury common shares at the higher of the average daily price or year-end closing price of the Common Stock.

Other Policies

Vessel charter costs are expensed on a straight-line basis over the estimated vessel service life (generally 15 years). Charter agreements generally provide for an initial 10-year period and renewals thereafter at reduced rates. The difference between charter payments and the straight-line cost is included as a deferred charge on the balance sheet.

Sales of products are recognized in income as customer shipments are made. Net sales include federal and foreign excise taxes on tobacco products of $1,201 million in 1974 and $965 million in 1973. The Company's transportation revenues and related vessel voyage expenses are generally recognized at commencement of the voyage.

In accordance with generally accepted accounting principles, the excess of cost over net assets of businesses acquired subsequent to October 31, 1970, is being amortized over a 40-year period. Generally, amounts recorded prior to that date are not being amortized since the Company believes no diminution in these assets has occurred.

The Company's policy is to expense research, development and other similar costs as incurred.

The Company includes in other (income) expense, net, items of a financial nature, principally interest income.

NOTE B—
LONG-TERM DEBT

(Dollars in Thousands)

	December 31, 1974		December 31, 1973	
	Due Within One Year	Due After One Year	Due Within One Year	Due After One Year
Long-term debt consists of the following:				
7½ % Ship Mortgage Bonds, payable in Deutschemarks, with semi-annual sinking fund payments through 1987	$13,496	$154,229	$13,496	$167,725
Ship Mortgage Bonds, with interest at 8½ % and 8¾ % payable in Dutch Guilders, with semi-annual sinking fund payments through 1981	11,390	62,851	11,391	74,241
7⅜ % Debentures, due February 1, 2001, with annual sinking fund payments beginning in 1982	—	100,000	—	100,000
7⅞ % Debentures, due September 1, 1994, with annual sinking fund payments beginning in 1975 (reduced by $6,778 of such debentures held by the Company on December 31, 1974 for future sinking fund requirements)	—	93,222	—	100,000
8⅛ % Notes, due September 1, 1974	—	—	50,000	—
7% Subordinated Debentures, due June 1, 1989, with annual sinking fund payments beginning in 1980	—	15,849	—	15,849
Other indebtedness with various interest rates and maturities	8,925	29,212	9,266	21,367
	$33,811	$455,363	$84,153	$479,182

The payment schedule of debt due after one year is as follows (dollars in thousands): 1976—$36,982; 1977—$34,463; 1978—$32,204; 1979—$32,191; 1980 and later—$319,523.

NOTE C—
COMMITMENTS AND CONTINGENCIES

In July, 1974, two civil actions purporting to be class actions were brought against the six major United States cigarette manufacturers, including the Company, and others, by certain tobacco farmers alleging violations of the antitrust laws and seeking damages aggregating approximately $2.5 billion plus attorneys' fees and costs. Both actions are in their early stages and investigation of the facts is not complete. Counsel has advised the Company, based on its investigation and the formal discovery to date, that in its opinion these cases are not proper class actions and the Company has substantial factual and legal defenses to the charges made. Accordingly, the Company has made no provision for this matter in its financial statements.

The Company and its subsidiaries are involved in certain other litigation, renegotiation and customs matters which in the aggregate are not expected to have any material adverse effect on the Company's financial statements.

The Company had various capital spending commitments of approximately $55 million at December 31, 1974.

Leases and charters for vessels and related equipment and facilities are used extensively in connection with the transportation business. Charters for vessels generally have initial periods of 10 years with renewal periods of up to 30 additional years. Leases for other major equipment and facilities have terms ranging from 5 to 25 years.

Lease expense was as follows:

	(Dollars in Thousands)	
	1974	1973
Non-financial leases	$18,170	$22,277
Financial leases	37,642	31,367
Total noncancelable leases	55,812	53,644
Other leases	33,989	25,404
Total lease expense	$89,801	$79,048

At December 31, 1974, the Company was obligated under noncancelable lease agreements to make minimum payments in future years as follows:

	(Dollars in Thousands)		
	Non-Financial	Financial	Total
1975	$18,544	$38,239	$56,783
1976	15,212	38,152	53,364
1977	12,217	37,660	49,877
1978	10,058	37,293	47,351
1979	9,256	36,611	45,867
1980-1984	14,529	134,420	148,949
1985-1989	6,459	89,276	95,735
1990-1994	769	64,740	65,509
Remainder	31	45,857	45,888

The net present values of the Company's future minimum lease obligations under financial leases at December 31, 1974 and 1973 are shown below by type of property along with the weighted average and range of interest rates specified or implicit in the leases.

			(Dollars in Thousands)	
	1974 Interest Rates		**Present Value Amounts**	
Property	Weighted Average	Range	1974	1973
Land and buildings	7%	3%-9%	$111,794	$110,791
Vessels, containers, and other equipment	7%	3%-17%	176,119	133,710
			$287,913	$244,501

If all noncancelable financing leases were capitalized, there would be no material effect on net earnings.

**NOTE D—
PROPOSED
ACQUISITION OF
UNITED STATES LINES**

In 1970, an agreement was entered into with Walter Kidde & Company, Inc. and United States Lines, Inc. under which Reynolds Tobacco would acquire all of the Common Stock of United States Lines in exchange for a $65 million promissory note payable to Kidde. The note is issuable upon such exchange, will be due no later than November 9, 1976, and will bear interest from November 9, 1970, at an annual rate of 8 percent plus interest at the rate of 6 percent per annum on deferred installments of interest. The agreement provides that if approval of the agreement is not obtained from the Federal Maritime Commission and the Interstate Commerce Commission or if the consummation of the transaction is barred by a court order which has become final, the acquisition will not be consummated and a previously announced time charter and lease by Sea-Land of 16 United States Lines container-ships and supporting equipment will be cancelled. In such event Reynolds Tobacco has undertaken under a supplemental agreement (the consummation of which is barred by a court order as noted below) with Kidde to cause the stock or assets of United States Lines to be disposed of no later than November 9, 1976, and to assure Kidde of consideration acceptable to Kidde of $65 million plus interest from November 9, 1970. During 1973, the Federal Maritime Commission approved the acquisition agreement, subject to certain conditions, but disapproved the supplemental agreement. However, the Commission's decision was vacated during 1974 by an United States Court of Appeals, and the United States Supreme Court has declined to review the Court of Appeals decision. The Interstate Commerce Commission has not yet rendered its final decision on the proposed acquisition.

Pursuant to an order entered by an United States District Court in an antitrust suit brought by the Department of Justice in 1970, the Company is prohibited from consummating the acquisition and the supplemental agreement pending further order of the Court. Since the Company cannot acquire United States Lines without the dissolution of such order, the Company's financial statements do not reflect the financial results of United States Lines, the $65 million promissory note issuable upon the consummation of the proposed acquisition or any interest thereon.

An antitrust action was brought by a competitor in 1969 alleging violations of the antitrust laws and seeking to enjoin the time charter and lease referred to above. At the same time, the competitor requested that Reynolds Tobacco be required to divest itself of McLean Industries, Inc., the parent of Sea-Land, and that Kidde be required to divest itself of United States Lines. In the opinion of counsel, this suit is without merit as to Reynolds Tobacco, McLean and Sea-Land.

The Company believes the outcome of the foregoing matters should have no material adverse effect on the Company's financial statements.

NOTE E—
CAPITAL CHANGES AND RELATED MATTERS

(Dollars in Thousands)	1974	1973
$2.25 Convertible Preferred Stock—without par value ($10.57 per share stated value)		
Balance at beginning of year	$ 74,696	$ 75,750
Shares sold under substitute stock options at prices of $37.25 and $42.50 (43,625 shares in 1973)	—	461
Shares converted into Common Stock (222,397 shares in 1974 and 143,375 in 1973)	(2,351)	(1,515)
Balance at end of year	$ 72,345	$ 74,696
Common Stock—Par $5		
Balance at beginning of year	$210,565	$209,490
Shares issued upon conversion of Preferred Stock (333,595 shares in 1974 and 215,062 in 1973)	1,669	1,075
Balance at end of year	$212,234	$210,565
Paid-in capital		
Balance at beginning of year	$ 45,331	$ 40,566
Net proceeds from conversion of Preferred Stock into Common Stock	5,575	3,595
Net proceeds from exercise of substitute stock options	—	1,170
Balance at end of year	$ 50,906	$ 45,331

Each share of the Preferred Stock is convertible into 1.5 shares of the Company's Common Stock on surrender of the preferred share and payment of $22 in cash. Upon conversion the cash proceeds and the stated value of the converted preferred shares less the par value of the common shares issued is credited to paid-in capital. The Company may redeem the Preferred Stock after June 30, 1979, at $50 per share (aggregating $342 million at December 31, 1974) plus accrued dividends to the redemption date. In the event of involuntary liquidation, holders of the Preferred Stock are entitled to $10.57 per share plus accrued dividends. Of the authorized but unissued common shares at December 31, 1974, 10,266,543 were reserved for conversion of 6,844,362 shares of preferred shares issued.

The substitute stock options issued May 13, 1969, in connection with the acquisition of McLean Industries expired January 7, 1974.

In conjunction with the Career Executive Stock Plan approved by the stockholders at the annual meeting held April 24, 1974, options to purchase 122,500 shares of the Company's Common Stock have been granted to certain employees at a price of $43.4375 per share. The maximum number of shares which may be purchased through these options is 600,000 and individual purchases are limited to 30,000 shares each. The options granted are not exercisable until May 1, 1975, and consist of 47,050 qualified and 75,450 unqualified options that expire on April 24, 1979 and 1984, respectively.

NOTE F—
PROVISION FOR INCOME TAXES

The provision for income taxes consists of the following:

	(Dollars in Thousands) 1974	1973
Current:		
Federal	$192,171	$119,257
State	22,693	23,065
Foreign	230,187	46,277
Total	445,051	188,599
Deferred:		
Federal	24,199	39,112
State	269	327
Foreign	(1,560)	3,379
Total	22,908	42,818
Total income taxes	$467,959	$231,417

Deferred income tax expense results from timing differences in the recognition of revenue and expense for book and tax purposes. The sources of these differences and the tax effect of each were as follows:

	(Dollars in Thousands) 1974	1973
Excess of tax over book depreciation	$ 15,232	$ 24,157
Vessel construction loan interest capitalized	—	3,829
Various other items	7,676	14,832
Deferred income taxes	$ 22,908	$ 42,818

The effective tax rate was 60.1 percent in 1974 and 46.8 percent in 1973. The differences between the amounts recorded and the amounts computed by applying the federal income tax rate of 48 percent to earnings before provision for income taxes is explained as follows:

	(Dollars in Thousands) 1974		1973	
	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income
Income tax computed at statutory U.S. federal income tax rate	$373,755	48.0%	$237,593	48.0%
Taxes on foreign operations in excess of statutory U.S. federal income tax rate	79,221	10.2	954	0.2
State taxes, net of federal tax benefit	11,940	1.5	12,163	2.5
Investment tax credit	(5,716)	(0.7)	(30,180)	(6.1)
Miscellaneous items	8,759	1.1	10,887	2.2
Provision for income taxes	$467,959	60.1%	$231,417	46.8%

No provision has been made for U. S. income taxes that may be payable upon remittance of earnings retained abroad by foreign subsidiaries, since it is the Company's intention to reinvest these earnings abroad, and since any such taxes that might be due would be largely offset by foreign tax credits.

There are a number of issues pending as a result of Internal Revenue Service audits, which are not expected to have a material effect on the Company's financial statements.

NOTE G— PENSION PLANS

The Company provides retirement benefits for substantially all of its regular full-time employees through Company administered plans and plans administered by labor unions under collective bargaining agreements. The Company's policy with respect to Company administered plans is to fund pension costs accrued.

Certain amendments to the Company administered pension plans will be required by January 1, 1976, to comply with the provisions of the Employee Retirement Income Security Act of 1974, the principal change being to provide for earlier vesting rights for plan members. Had these changes been effective for 1974, pension expense would have been increased by approximately $3 million according to actuarial estimates.

The total expense for the Company administered plans was $21 million in 1974 compared with $20 million in 1973. A modification was made to the funding method whereby separate recognition was given to unfunded past service costs with such costs to be funded over 30 years, which had the effect of reducing 1974 pension expense by approximately $2 million. Cost increases arising from improvement in benefits have been largely offset by an actuarial assumption change to reflect an increase in assumed trust fund earnings.

The assets of the Company administered plans exceeded the actuarially computed value of vested benefits according to the most recent actuarial valuations.

The Company makes payments under the terms of various collective bargaining agreements to provide welfare benefits, including pension benefits, for employees covered under such agreements.

NOTE H— ACQUISITION OF MACDONALD TOBACCO INC.

On February 15, 1974, the Company acquired the stock of Macdonald Tobacco Inc., a Canadian manufacturer and distributor of cigarettes, smoking tobacco and cigars, for $75 million. The purchase was effective January 1, 1974, and the accounts of Macdonald Tobacco are therefore included in the consolidated statements from that date.

The following unaudited summary, on a pro forma basis, depicts the combined operating results of the Company and Macdonald Tobacco for 1973 assuming the acquisition had taken place on January 1, 1973.

Net sales and revenues	$3,549,391,000
Earnings from operations	533,771,000
Net earnings	263,196,000
Net earnings per common share:	
Primary	5.88
Fully diluted	5.34

NOTE I— SALE OF CERTAIN TRANSPORTATION OPERATIONS

Effective September 30, 1974, the Company sold to the Puerto Rico Maritime Shipping Authority for $83 million (the approximate underlying carrying value) the part of its transportation business engaged in providing containerized ocean freight service between Puerto Rico and the East and Gulf Coasts of the United States. Approximately $76 million of the sale price was received in secured promissory notes of the Authority payable in installments over the next six years. The portion of these notes due after one year is included in other assets and deferred charges on the balance sheet.

The business sold contributed approximately $85 million and $95 million to the Company's sales and revenues during the first nine months of 1974 and the full year 1973, respectively. Interest on the proceeds from the sale and management fees accruing to the Company under a related contract are expected to approximate the earnings that would have been realized from this business.

REPORT OF INDEPENDENT ACCOUNTANTS

Ernst & Ernst
2015 Wachovia Building
Winston-Salem, N.C.

R. J. Reynolds Industries, Inc.
Its Directors and Stockholders

We have examined the consolidated balance sheets of R. J. Reynolds Industries, Inc. and subsidiaries as of December 31, 1974, and December 31, 1973, and the related consolidated statements of earnings, earnings retained and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note C to the financial statements, the Company and others, including all major United States cigarette manufacturers, are defendants in lawsuits alleging violations of antitrust laws. The Company's counsel, based on its investigation and formal discovery to date, is of the opinion the Company has substantial factual and legal defenses to the charges made. Accordingly, the Company has made no provision for this matter in its financial statements.

In our opinion, subject to the effects, if any, of the ultimate resolution of the matter discussed in the preceding paragraph, the financial statements referred to above present fairly the consolidated financial position of R. J. Reynolds Industries, Inc. and subsidiaries at December 31, 1974 and 1973, and the consolidated results of their operations and the changes in their consolidated financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Ernst

February 12, 1975

BOARD OF DIRECTORS

COLIN STOKES
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R. J. Reynolds Industries, Inc.

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President,
R. J. Reynolds Industries, Inc.

DAVID S. PEOPLES
Vice Chairman,
R. J. Reynolds Industries, Inc.

S. A. ANGOTTI
Retired Senior Vice President,
R. J. Reynolds Industries, Inc.

C. F. BENBOW
Senior Vice President,
R. J. Reynolds Industries, Inc.

HERSCHEL H. CUDD
Senior Vice President,
Standard Oil Company (Indiana)

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Retired Chairman,
R. J. Reynolds Industries, Inc.

GORDON GRAY[4]
Chairman of the Board,
Summit Communications, Inc.

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President,
R. J. Reynolds Tobacco Company

WALTER L. LINGLE, JR.[4]
Former Executive Vice President
The Procter & Gamble Company

WILLIAM R. LYBROOK
Senior Vice President and Secretary,
R. J. Reynolds Industries, Inc.

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Investments

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Vice President and General Counsel,
R. J. Reynolds Industries, Inc.

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Vice President,
R. J. Reynolds Tobacco Company

WILLIAM S. SMITH[1]
Chairman,
R. J. Reynolds Tobacco Company

CHAS. B. WADE, JR.
Senior Vice President,
R. J. Reynolds Industries, Inc.

OFFICERS

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Chairman and Chief Executive Officer

J. PAUL STICHT
President and Chief Operating Officer

DAVID S. PEOPLES
Vice Chairman, and Chairman of the Executive Committee

WILLIAM R. LYBROOK
Senior Vice President and Secretary

C. F. BENBOW
Senior Vice President

CHAS. B. WADE, JR.
Senior Vice President

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Vice President

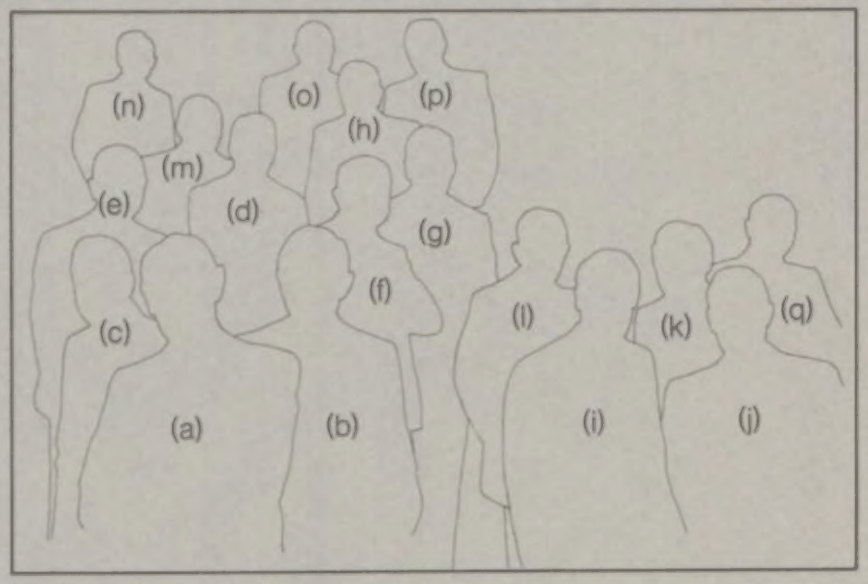
H. C. ROEMER
Vice President and General Counsel

R. D. THOMPSON
Vice President

J. W. DOWDLE
Treasurer

R. A. EMKEN
Comptroller

[1]Elected a Vice Chairman, R. J. Reynolds Industries, Inc., January 16, 1975.
[2]Elected Chairman, Chief Executive Officer and President, R. J. Reynolds Tobacco Company, January 16, 1975.
[3]Chairman, Audit Committee.
[4]Member, Audit Committee.



(a) COLIN STOKES (b) J. PAUL STICHT (c) DAVID S. PEOPLES (d) S. A. ANGOTTI (e) C. F. BENBOW (f) HERSCHEL H. CUDD (g) A. H. GALLOWAY (h) GORDON GRAY (i) WM. D. HOBBS (j) WALTER L. LINGLE, JR. (k) WILLIAM R. LYBROOK (l) MALCOM P. McLEAN (m) CHARLES F. MYERS, JR. (n) H. C. ROEMER (o) J. H. SHERRILL (p) WILLIAM S. SMITH (q) CHAS. B. WADE, JR.

Registrar
MANUFACTURERS HANOVER TRUST COMPANY
Corporate Trust Division
4 New York Plaza
New York, New York 10015

Transfer Agents
THE CHASE MANHATTAN BANK, N.A.
1 New York Plaza, 14th Floor
New York, New York 10015

FIRST JERSEY NATIONAL BANK
1 Exchange Place
Jersey City, New Jersey 07303

Dividend Reinvestment and Conversion Agent
THE CHASE MANHATTAN BANK, N.A.
1 New York Plaza, 14th Floor
New York, New York 10015

Stockholder Inquiries
Communications concerning transfer requirements and lost certificates should be directed to either Transfer Agent. Communications concerning dividends and change of address should be directed to R. J. Reynolds Industries, Inc., Shareholder Services Department, Box 2959, Winston-Salem, North Carolina 27102.

Common and Preferred Shares
Listed on the New York Stock Exchange (trading symbol: RJR).

Corporate Headquarters
Reynolds Building
Fourth & Main Streets
Winston-Salem, North Carolina 27102
Telephone: (919) 748-4000

Notice of Annual Meeting
The Annual Meeting of the Company's stockholders will be held at the M. C. Benton Convention Center, Fifth & Cherry Streets, Winston-Salem, North Carolina, at 2:00 p.m., local time, on Wednesday, April 23, 1975. (The 1975 meeting is to take place in Winston-Salem as part of the observance of the centennial year of R. J. Reynolds Tobacco Company.) A formal notice of the meeting, together with Proxy Statement and Proxy, will be mailed to stockholders of record at the close of business February 25, 1975.

Availability of Form 10-K

On or after April 1, 1975, a copy of the Company's Annual Report to the Securities and Exchange Commission on Form 10-K for the year ended December 31, 1974, will be provided to stockholders upon written request to the Secretary, R. J. Reynolds Industries, Inc., Winston-Salem, North Carolina 27102.

RJR

R.J.Reynolds Industries, Inc.

Winston-Salem, N.C. 27102